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Supreme Court, U.S.
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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLAREMORE, OKLAHOMA, AND GREAT PLAINS FEDERAL SAVINGS AND LOAN ASSOCIATION (FORMERLY CUSTER COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION) OF WEATHERFORD, OKLAHOMA,

Appellants,

v.

THE OKLAHOMA TAX COMMISSION OF THE STATE OF OKLAHOMA,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF OKLAHOMA

JURISDICTIONAL STATEMENT

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December, 1987

QUESTIONS PRESENTED

1. Whether the constitutional immunities conferred by the borrowing and supremacy clauses upon interest generated by the obligations of federal agencies and instrumentalities renders the Oklahoma corporate income tax (68 Okla. Stat. § 2355C. (1981)), unconstitutional as applied to interest derived by appellants from overnight/demand deposits maintained with a Federal Home Loan Bank and from bonds issued by the Federal National Mortgage Association.

2. Whether statutory immunities provided by 12 U.S.C. § 1433 (1982), with respect to obligations of Federal Home Loan Banks, and by 31 U.S.C. § 3124 (1982) (formerly 31 U.S.C. § 742) render the Oklahoma corporate income tax invalid as applied to interest derived by appellants from overnight/demand deposits maintained with a Federal Home Loan Bank and from bonds issued by the Federal National Mortgage Association.

PARTIES BELOW

A list of all parties to the proceedings below is as follows: First Federal Savings and Loan Association of Claremore, Great Plains Federal Savings and Loan Association (formerly Custer County Federal Savings and Loan Association) of Weatherford, Oklahoma, and the Tax Commission of the State of Oklahoma.

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v.

THE OKLAHOMA TAX COMMISSION OF THE STATE OF OKLAHOMA,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF OKLAHOMA

JURISDICTIONAL STATEMENT

Appellants indicated in the caption above ("Appellants") appeal from a judgment issued by the Supreme Court of Oklahoma on May 26, 1987, and with respect to which Appellants' Petition for a Rehearing was denied on October 7, 1987. This Jurisdictional Statement is submitted to show that this Court has jurisdiction on this appeal and that the appeal presents substantial questions of constitutional and federal statutory law concerning the attempted application of the Oklahoma corporate income tax to interest on certain obligations of two federal agencies.

OPINION BELOW

The opinion of the Oklahoma Supreme Court dated May 26, 1987, rehearing denied October 7, 1987, is reported at 743 P.2d 640 (Okla. 1987).[1]

STATEMENT OF JURISDICTION

This action was a consolidated appeal in the Supreme Court of Oklahoma of orders by the Oklahoma Tax Commission (the "Commission") denying protests by Appellants of proposed assessments of Oklahoma corporate income tax.[2] In both "In the Matter of the Protest of Great Plains Federal Savings and Loan Association (formerly Custer County Federal Savings and Loan Association) of Weatherford, Oklahoma, to the Proposed Assessment of Additional Income Tax Issued January 14, 1983" (the "Great Plains Protest"), which was styled case number P-83-048 before the Commission, and "In the Matter of the Protest of First Federal Savings and Loan Association of Claremore, Oklahoma, to the Proposed Assessment of Additional Income Tax Issued December 7, 1982" (the "First Federal Protest"), which was styled case number P-83-039 before the Commission, Appellants contended that the proposed imposition of the Oklahoma corporate income tax to interest received by Appellants on various obligations of certain federal agencies and instrumentalities was unconstitutional under the borrowing and supremacy clauses of the United States Constitution and, in certain instances, directly conflicted with specific federal statutory exemptions. In particular, Appellants contended that interest they received on overnight/demand deposits maintained by them with the

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[1] See Appendix A.

[2] See Appendices B and C.

Federal Home Loan Bank in Topeka, Kansas, is specifically protected from state taxation by the immunities prescribed in 12 U.S.C. § 1433 (1982), which are applicable to obligations of a Federal Home Loan Bank. Appellants also argued that, as applied to interest received on the Federal Home Loan Bank deposits and to interest received by them from bonds issued under authority of 12 U.S.C. § 1719(b) (1982) by the Federal National Mortgage Association, the Oklahoma corporate income tax transgressed the immunities from state taxation contained in the borrowing and supremacy clauses of the United States Constitution and was, to that extent, unconstitutional.

STATUTES INVOLVED

This appeal concerns both (a) whether the Oklahoma corporate income tax, expressed at 68 Okla. Stat. § 2355C (1981)[3], as applied to interest generated by overnight/demand deposits maintained by Appellants with the Federal Home Loan Bank in Topeka, Kansas, and to interest derived by Appellants from bonds issued by the Federal National Mortgage Association, conflicts with, and is invalidated by, the borrowing[4] and supremacy[5] clauses of the United States Constitution, and the provisions of former Section 742 of Title 31 of the United States Code,[6] and (b) whether the Oklahoma corporate income tax as applied to interest on the Federal Home Loan Bank demand deposits

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[3] See Appendix G.

[4] See Appendix H.

[5] See Appendix I.

[6] Presently expressed, without substantive change, in 12 U.S.C. § 3124 (1982). See Appendix M.

conflicts with 12 U.S.C. § 1433 (1982)[7] which cloaks obligations of a Federal Home Loan Bank with certain specific immunities from state taxation.

STATEMENT OF THE CASE

The Commission proposed additional assessments of Oklahoma corporate income tax for First Federal Savings and Loan Association of Claremore ("First Claremore") on December 7, 1982, and for Great Plains Federal Savings and Loan Association of Weatherford ("Great Plains") on January 14, 1983. Both proposed assessments included the issues of whether interest derived by Appellants from bonds issued by the Federal National Mortgage Association and from demand deposits maintained by them with the Federal Home Loan Bank in Topeka, Kansas, could properly be subjected to the Oklahoma corporate income tax. In addition, both First Claremore and Great Plains protested the proposed taxation of interest derived from monies loaned on their behalf by the Federal Home Loan Bank in Topeka through the Federal Reserve system, so-called "fed funds" transactions; and Great Plains included in its protest attempts by the Commission to tax interest received on prepaid insurance premiums maintained with the Federal Savings and Loan Insurance Corporation (the "FSLIC") and interest on bonds issued by the Federal Home Loan Mortgage Corporation. Appellants filed timely protests of the proposed assessments, in each case contending that, as to the demand deposits maintained with the Federal Home Loan Bank in Topeka, 12 U.S.C. § 1433 (1982), as construed by this Court in a prior opinion, rendered the Oklahoma taxing statute invalid in any such application, while the constitutional immunities and protections

[7] See Appendix K.

generally accorded federal agencies and instrumentalities by the borrowing and supremacy clauses of the United States Constitution, and the correlative immunities contained in 31 U.S.C. § 3124 (1982) (formerly 31 U.S.C. § 742), rendered the Oklahoma taxing statute invalid when extended to interest produced by the obligations of all the federal agencies involved in the protests, including, without limitation, the Federal Home Loan Bank demand deposits and the bonds issued by the Federal National Mortgage Association.

The First Federal Protest was denied by the Commission by Order No. 85-05-30-39, issued on May 30, 1985, while the Great Plains Protest was denied by Order No. 85-05-30-07, also issued by the Commission on May 30, 1985. In each case, the Commission found the interest income to be "income earned on a property right" and subject to tax under the general authority contained in 12 U.S.C. § 1464(h) (1982) which authorizes states to tax the income of federally-chartered savings and loan associations.[8]

On June 26, 1985, each Appellant appealed to the Oklahoma Supreme Court that portion of the Order of the Commission relating to the overnight/demand deposits and the bonds issued by the Federal National Mortgage Association, with Great Plains also including in its appeal the Commission's determination that interest derived from the FSLIC prepaid insurance fund and from bonds issued by the Federal Home Loan Mortgage Corporation was properly subject to the Oklahoma corporate income tax. The First Federal of Claremore appeal was docketed as case number 64,673, while the Great Plains appeal was assigned case

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[8] See paragraphs (4), (9), and (11) of Part III of Commission Order No. 85-05-30-07, and paragraphs (4), (8), and (9) of Part III of Commission Order No. 85-05-30-39, and both of which are set forth in Appendices B and C, respectively.

number 64,674. Because of the common issues involved, the cases were consolidated on July 17, 1985. On May 26, 1987, the Oklahoma Supreme Court issued its opinion holding the Oklahoma corporate income tax did not apply to interest derived from bonds issued by the Federal Home Loan Mortgage Corporation, but was applicable to interest produced by the other federal obligations, and did not conflict with applicable federal statutes or constitutional provisions. The Appellants filed a timely Petition for Rehearing which was denied, without opinion, on October 7, 1987.[9] Appellants do not appeal from that portion of the opinion holding that interest generated by the FSLIC prepaid deposit fund is properly taxable by the State of Oklahoma.

HOW THE FEDERAL QUESTIONS WERE PRESENTED

The issues of whether (a) the exemptions from state taxation contained in the enabling statutes of the Federal Home Loan Banks, 12 U.S.C. § 1433 (1982), extend to interest generated by overnight/demand deposits maintained by Appellants with the banks, and (b) whether the constitutional and statutory immunities which generally protect the operations of federal agencies and instrumentalities rendered invalid any extension of the Oklahoma corporate income tax to interest received by Appellants on bonds issued by the Federal National Mortgage Association were presented to the Commission in the protests filed by Appellants to the December 7, 1982, and January 14, 1983 proposed assessments. Appellants again raised the issues in their Petitions-In-Error and Brief in Chief. The Oklahoma Supreme Court considered and disregarded Appellants' arguments in its May 26, 1987

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[9] See Appendix E.

opinion. The same statutory and constitutional issues were again presented to the Court by Appellants in their Petition for Rehearing, and accompanying Brief, which Petition was denied, without discussion, by the Oklahoma Supreme Court by Order dated October 7, 1987.

By upholding the validity of the Oklahoma corporate income tax, as applied to interest generated by overnight/demand deposits maintained with the Federal Home Loan Bank and by bonds issued by the Federal National Mortgage Association, in the face of assertions that such applications were unconstitutional and in direct conflict with applicable federal law, the United States Supreme Court's jurisdiction was invoked under 28 U.S.C. § 1257(2) (1982).

THE QUESTION IS SUBSTANTIAL

IMPOSITION OF THE OKLAHOMA CORPORATE INCOME TAX ON INTEREST GENERATED EITHER BY DEPOSITS MAINTAINED WITH A FEDERAL HOME LOAN BANK OR BY BONDS ISSUED BY THE FEDERAL NATIONAL MORTGAGE ASSOCIATION DIRECTLY INTERFERES WITH THE ABILITY OF THOSE FEDERAL AGENCIES TO DISCHARGE THEIR CONGRESSIONALLY MANDATED FUNCTIONS IN THE MOST EFFICIENT MANNER AND CONFLICTS WITH SPECIFIC CONSTITUTIONAL AND STATUTORY IMMUNITIES.

Generally, federal instrumentalities, and the functions they perform, are protected from state interference, whether the interference takes the form of taxation or regulatory efforts. Flowing from the Supremacy Clause, such protection first found expression in the "implied immunity doctrine" set forth by Justice Marshall in *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), where the ability of a state to impose a

tax on a federal agency was first limited. While stating the oft-repeated maxim "the power to tax involves the power to destroy," the Court invalidated a tax the State of Maryland sought to place on the functions of a bank incorporated by an act of Congress. *Id.* at 431. Specifically, Maryland sought to tax the act of issuing bank notes by requiring the bank to purchase from the state stamped paper on which the notes were printed, or by paying $15,000 to a Maryland State official. Similarly, in *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21, 32 (1939), the Court found the Homeowners' Loan Corp. to be a constitutional exercise of congressional power and its activities to be entitled, under the implied immunity doctrine, "to whatever immunity attaches to those functions when performed by the government itself through its departments."

Where Congress has created a federal agency or instrumentality and charged it with the responsibility of conducting activities which are properly within the province of the government to perform, a state may not interfere with those activities or burden them by taxation or regulatory interference. For example, in *Farmers & Mechanics Savings Bank v. Minnesota*, 232 U.S. 516 (1914), the Court determined that bonds issued by municipal corporations formed under the laws of the territory of Oklahoma, and for which the United States Treasury and the territory of Oklahoma were in no way liable, could not properly be taxed by Minnesota when held by a Minnesota bank. In holding the tax unconstitutional under the supremacy clause, the Court observed that as the corporations were instruments of another federal instrumentality, the territory of Oklahoma, they also were "instrumentalities and agencies of the federal government," with whose operations the states were not permitted to interfere by taxation or otherwise. *Id.* at 525.

Similarly, under the borrowing clause of the United States Constitution, obligations of the federal government, and interest generated by them, are immune from state taxation. *See, Weston v. City Council of Charleston*, 27 U.S. (2 Peters) 449 (1829), *and Society for Savings v. Bowers*, 329 U.S. 143 (1955). Until the Civil War, it was not thought necessary to codify the constitutional maxim that a "state cannot by any form of taxation, impose any burden upon any part of the public debt." *Home Savings Bank v. Des Moines*, 205 U.S. 503, 513 (1907). The obvious purpose of the immunity is to enable the government to raise monies to fund its responsibilities in the most efficient manner, i.e., at the lowest possible public cost. However, the large issuance of notes by the United States Treasury to finance the war effort made Congress cautious and prompted the enactment of the forerunner of present Section 3124 of Title 31 of the United States Code. *Home Savings Bank v. Des Moines, supra.*

Section 3124, and its predecessors, prohibit any direct state taxation of interest on federal obligations, whether or not such taxation is discriminatory with respect to the obligations. *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983); *Society for Savings v. Bowers*, 329 U.S. at 144. The statutory immunities presented in Section 3124 appear redundant. Indeed, in *Macallen Co. v. Massachusetts*, 279 U.S. 620 (1929), the Court, in commenting upon an express statutory exemption applicable to Federal Farm Loan Bonds, stated that "the statutory exemption is superfluous." *Id.* at 624. Certain indirect forms of taxation, such as franchise taxes or similar privilege taxes, but not including a "direct" tax such as the Oklahoma corporate income tax, are permitted under the terms of the statute if not they do not discriminate between similar federal and state obligations.

Again, the purpose of both constitutionally and statutorily prescribed immunities is the protection of governmental functions from state interference. Whether those functions are performed directly by the government, or by an agency or instrumentality, the immunities continue to extend to and protect the underlying activities. *Pittman v. Home Owners' Loan Corp.*, 308 U.S. at 32. To the extent, therefore, a Federal Home Loan Bank or the Federal National Mortgage Association performs congressionally mandated services which are properly within the scope of governmental activities, those services are entitled to the same statutory and constitutional protections otherwise available to activities conducted by the government itself.

Federal Home Loan Banks were created pursuant to the Federal Home Loan Bank Act of 1932, Pub. L. No. 72-304, 47 Stat. 725 (codified as amended at 12 U.S.C. §§ 1421-1449 (1982)), for the purpose of placing:

> "long-term funds in the hands of local institutions" in order to alleviate the pressing need of home owners for "low-cost, long-term, installment mortgage money" and "to decrease costs of mortgage money" with a "resulting benefit to home ownership in the form of lower costs and more liberal loans."

Laurens Fed. Sav. & Loan Ass'n v. South Carolina Tax Comm., 365 U.S. 517, 522 (1961) (quoting H.R. Rep. No. 1418, 72d Cong., 1st Sess. 8-10 (1931) and S. Rep. No. 837, 72d Cong., 1st Sess. 9-11 (1931)).

In furtherance of their congressionally designated public purpose, each bank is authorized to borrow money, including borrowings occasioned by issuing its obligations "upon such terms and conditions as the board may approve." 12 U.S.C. § 1431(a) (1982). As a partial expression of its borrowing

powers, a bank is authorized to accept deposits and to pay interest thereon. 12 U.S.C. § 1431(e) (1982); 12 C.F.R. § 524.4 (1982).[10] All amounts received by Appellants as interest on overnight deposits with a Federal Home Loan Bank and involved in these appeals were loaned by Appellants to the Federal Home Loan Bank, and borrowed by the Federal Home Loan Bank in Topeka, under authority of 12 C.F.R. § 524.4(b) (1978) as then in effect. Deposits made by Appellants to the Federal Home Loan Bank under the overnight deposit program represented an obligation of the bank to repay the borrowed funds to Appellants, together with interest at such rates as may have been established by the Federal Home Loan Bank in accordance with the provisions of the above-cited regulation. Deposits, such as those made by Appellants, are commonly transacted by savings and loan associations throughout the state of Oklahoma and, presumably, throughout the United States. As the Federal Home Loan Banks provide a convenient repository for temporarily idle funds, and as the banks actively compete with other institutions and vehicles, e.g., Treasury Bills, for such funds, the ultimate resolution of whether interest generated by the deposits can be subjected to a state income tax will have a significant impact on the ability of the banks to solicit and retain those deposits. The underlying economics, therefore,

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[10] 12 C.F.R. § 524.4(b) (1978), during the fiscal years at issue, did not differ substantively from present Section 524.4, and, in pertinent part, read as follows:

> Banks may accept deposits from members, reserving the right to require notice of intention to withdraw any part of such deposits. Rates of interest paid on such deposits shall be set by the bank's board of directors, or between regular meetings thereof, by a committee of directors selected by the board, or the Bank President if he is so authorized by the board.

can be expected to have a substantial, if not profound, effect upon the financial costs of a bank such as the Federal Home Loan Bank in Topeka which obtains considerable deposits from savings institutions in states, e.g., Oklahoma, seeking to subject interest on the deposits to a direct tax. The importance of protecting a bank's borrowing activities from state interference is specifically recognized in Section 1433 of Title 12 of the United States Code which provides, in relevant parts, as follows:

> Any and all notes, debentures, bonds, and other such obligations issued by any Federal Home Loan Bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority.

12 U.S.C. § 1433 (1982).

In construing and determining the scope of the statutory exemptions contained within Section 1433, this Court has historically looked to the underlying purpose of an exemption, i.e, the function to be protected and the reason for the protection. In *Laurens Fed. Sav. & Loan Ass'n v. South Carolina Tax Comm., supra,* a case which seems largely dispositive of the issues presented by this appeal with respect to Federal Home Loan Bank obligations, the State of South Carolina required a federal savings and loan association located within the state to pay a documentary stamp tax on promissory notes executed by the association in favor of a Federal Home Loan Bank. These notes were made to cover loans from the Federal Home Loan Bank to the savings and loan association. They were not, in other words, obligations of the Federal

Home Loan Bank itself, but rather of the savings and loan association, and the taxpayer claimed they constituted "advances" which were exempt from state tax by reason of the following language contained in Section 1433:

> [A Federal Home Loan Bank], including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States or . . . *by any State* . . . .

Lawrens, 365 U.S. at 519 (quoting 12 U.S.C. § 1433 (1982) (emphasis supplied by Court)).

The savings and loan association paid the taxes and sued for a refund asserting that the imposition of the tax was an unlawful attempt by the state to tax the "advances" of the Federal Home Loan Bank in violation of the above-cited statute, while the state asserted the notes were not "advances" within the meaning of the statute. The state additionally sought to defend the tax on the ground, among other things, that it was imposed on the savings institution rather than the Federal Home Loan Bank. In holding the tax invalid, the Court found that the promissory notes securing the advances fell within the term "advances" as used in Section 1433, and determined that the documents sought to be taxed "were indispensable elements in the lending operations authorized by Congress and were required for the protection of the lending institution." 365 U.S. at 521 (quoting *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21, 32 (1939)). Moreover, the notes qualified as "advances" because, upon judicial review, the language and legislative history of the Federal Home Loan Bank Act of 1932 mandated such a result. Specifically, the Court reasoned:

> The exemption of these "advances" from taxation obviously is in keeping with the Act's overall policy of making these mortgage funds available at low cost to homeowners.... In its impact, therefore, this tax, whether nominally imposed on the Bank or on the petitioner, is bound to increase the cost of loans to home owners and thus contravene the basic purpose of Congress in insulating these advances from state taxation.

Laurens, 365 U.S. at 522.

Similarly, the imposition of a state tax on interest generated by deposits maintained with a Federal Home Loan Bank invariably increases the cost of funds to the bank, thus resulting in corresponding increases in the cost of loans to bank customers. Such a result impermissibly compromises the bank's efficient discharge of its congressionally designated functions and specifically conflicts with both the purpose and the literal language of the exemptions from taxation accorded the borrowing functions and obligations of a Federal Home Loan Bank under 12 U.S.C. § 1433 (1982). Clearly, the objective of insulating obligations of the Federal Home Loan Banks and the interest they produce from state taxation is to reduce the cost of funds to the bank and thus enable the bank to discharge its functions in the most efficient, i.e., at the lowest cost, to the general public. In this regard, the objective is identical to that expressed in the borrowing clause of the Constitution and in 31 U.S.C. § 3124 (1982) (formerly 31 U.S.C. § 742). Accordingly, application of the Oklahoma corporate income tax to such interest is in direct conflict with specific federal statutes and is unconstitutional as well.

The Federal National Mortgage Association is a body corporate created on September 1, 1968, as a partial successor

to a corporate body of an identical name then located in the Department of Housing and Urban Development. Its stated purpose is to:

> (a) Provide supplementary assistance to the secondary market for home mortgages by providing a degree of liquidity for mortgage investments, thereby improving the distribution of investment capital available for home mortgage financing . . . .

12 U.S.C. § 1716(a) (1982) (made applicable to the Federal National Mortgage Association by 12 U.S.C. § 1719(a)(1) (1982)).

In furtherance of its legislatively prescribed functions on behalf of the public, the Federal National Mortgage Association is authorized to issue:

> [U]pon the approval of the Secretary of Treasury . . . obligations having such maturities and bearing such rate or rates of interest as may be determined by the corporation with approval of the Secretary of the Treasury . . . .

12 U.S.C. § 1719(b) (1982).

Any obligations issued by the Federal National Mortgage Association must contain appropriate language to the effect that they "are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the corporation." 12 U.S.C. § 1719(b) (1982). While not wishing to subject the Treasury to the liabilities of the Federal National Mortgage Association, Congress clearly recognized, by its use of the words "or of any agency or instrumentality other than the corporation" in Section 1719(b), the Federal National Mortgage Association as a federal agency or instrumentality and intended it to be such. In so doing,

Congress adopted a definition consistent with the judicial interpretation of a federal agency which, as set forth in *Graves v. New York*, 306 U.S. 466, 478 (1939) is "every agency which Congress can constitutionally create as a governmental agency." *See also, M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 435 (1819). While the association's obligations are not those of the Treasury itself, they are an essential element in the association's legislatively prescribed borrowing functions and, under the authorities previously cited, are entitled to the same protections as would attach to any aspect of the borrowing function conducted by the government itself.

The importance which Congress has attached to the mandated functions of the Federal National Mortgage Association is illustrated by the authorization, contained in the provisions of Section 1719(c) of Title 12 of the United States Code, for the association to borrow directly from the Treasury. Such authorization is designed to "constitute Government recognition of the significance of the corporation's operations to the national interest aspects of the mortgage financing industry." H.R. Rep. No. 1585, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. Code Cong. & Admin. News 2873, 2945. The bonds issued by the Federal National Mortgage Association and held by Appellants, and the interest on which is involved in this appeal, were issued under the authority of Section 1719(b).

Bonds issued by the Federal National Mortgage Association are frequently purchased by savings and loan associations and other financial intermediaries, in the state of Oklahoma and, presumably, in other states as well. The effective yield on the bonds determines their relative attractiveness. The issue of whether interest on the bonds is properly the subject of a state income tax will thus determine

whether the agency must pay a higher yield on its obligations in order to maintain their competitiveness. For the reasons discussed above in connection with obligations of the Federal Home Loan Banks, the borrowing functions of the Federal National Mortgage Association are an integral part of its federally prescribed responsibilities and are thus entitled to the same constitutional protections and immunities as would attach to those functions if directly performed by the government itself. Extension of the Oklahoma corporate income tax, therefore, to interest on bonds issued by the agency is proscribed by the implied immunities expressed in both the borrowing and supremacy clauses and by the specific immunities contained in 31 U.S.C. § 3124 (1982).

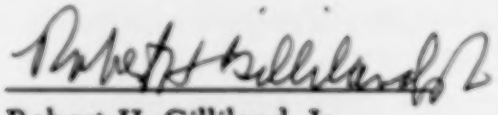
CONCLUSION

As a federal agency and instrumentality, a Federal Home Loan Bank and the Federal National Mortgage Association are each entitled to the same immunities in its respective operations as would attach to those operations if performed directly by a department of the federal government. *Pittman v. Homeowners' Loan Corp.*, 308 U.S. at 32. To the extent an application of the Oklahoma corporate income tax would interfere with those functions or burden them, the tax is both unconstitutional and in contravention of specific statutorily prescribed immunities.

The economic consequences of such a tax would be extensive and would not only significantly affect a large number of taxpayers, but would also compromise the ability of each agency to raise and lend funds at the lowest cost to the public, thus impacting the general public in a substantial and tangible manner.

For these reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,



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APPENDICES

Appendix A — Opinion of the Supreme Court of the State of Oklahoma

Appendix B — Order No. 85-05-30-07 of the Oklahoma Tax Commission

Appendix C — Order No. 85-05-30-39 (originally issued as Order No. 85-05-30-08) of the Oklahoma Tax Commission and Order Nunc Pro Tunc No. 85-05-30-39 of the Oklahoma Tax Commission

Appendix D — Order modifying opinion

Appendix E — Order denying rehearing

Appendix F — Notice of Appeal

Appendix G — 68 Okla. Stat. § 2355C (1981)

Appendix H — The borrowing clause of the United States Constitution, U.S. Const. art. I, Sec. 8, cl. 1 & 2.

Appendix I — The supremacy clause of the United States Constitution, U.S. Const. art. VI, cl. 2.

Appendix J — 12 U.S.C. § 1431 (1982)

Appendix K — 12 U.S.C. § 1433 (1982)

Appendix L — 12 U.S.C. § 1719 (1982)

Appendix M — 31 U.S.C. § 742 (currently expressed as 31 U.S.C. § 3124 (1982)

IN THE SUPREME COURT OF
THE STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLAREMORE, OKLAHOMA TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED DECEMBER 7, 1982, *Appellant,* and IN THE MATTER OF THE PROTEST OF GREAT PLAINS FEDERAL SAVINGS AND LOAN ASSOCIATION, (FORMERLY CUSTER COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION) OF WEATHERFORD, OKLAHOMA, TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED JANUARY 14, 1983, *Appellant,* v. OKLAHOMA TAX COMMISSION, *Appellee.*	No. 64,673 Consol. With No. 64,674

APPEAL FROM ORDER OF THE OKLAHOMA TAX COMMISSION

The appellants appeal from an order of the Oklahoma Tax Commission which assessed corporate income tax on the interest earned by the appellants from overnight/demand deposits, on interest earned on prepaid premiums credited to the secondary reserve maintained by the FSLIC, and on bonds issued by the Federal National Mortgage Association

and the Federal Home Loan Corporation. We find that the bonds issued by the Federal Home Loan Mortgage Corporation are exempt from taxation, but that the overnight/demand deposits, the bonds issued by the Federal National Mortgage Association, and the interest credited to the FSLIC's secondary reserve are taxable.

AFFIRMED IN PART; REVERSED IN PART

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For Appellants

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For Appellee.

Kauger, J.

The issue presented is whether certain corporate income earned by Oklahoma savings and loan associations is exempt from taxation by the state of Oklahoma. The income in question includes the interest earned on 1) overnight/demand deposits[1] placed in the Federal Home Loan Bank, 2) prepaid insurance premiums[2] credited to the secon-

[1] Demand deposits are funds accepted by a bank which are subject to immediate withdrawal. *United States v. Philadelphia National Bank*, 201 F. Supp. 348, 360 (E.D. Penn. 1962).

[2] Prior to 1973, when an institution had a two per centum net increase in all accounts, it was required to make an additional

dary reserve Federal Savings and Loan Insurance Corporation (FSLIC), 3) and bonds[3] issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). We find that the FHLMC bonds are exempt from taxation, but that the interest on the overnight/demand deposits, the bonds issued by FNMA, and the interest credited to the secondary reserve are taxable.

After office audits of the appellants, First Federal Savings and Loan Association of Claremore and Great Plains Federal Savings and Loan Association of Weatherford, the Oklahoma Tax Commission (OTC) issued its proposed assessment of additional income tax, penalties, and interest. The appellant savings and loan associations filed timely protests pursuant to 68 O.S. 1981 § 221.[4] However, because the parties stipulated to the facts, no formal hearing was conducted.

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premium payment in the nature of a prepayment for future premiums. *Commissioner v. Lincoln Savings & Loan Asso.*, 403 U.S. 345-46, 91 S.Ct. 1893, 29 L.Ed. 2d 519, 522 (1971).

[3] Bonds are obligations payable at a definite time, running through a series of years. *Shelly v. St. Charles County Court*, 21 F. 699, 701 (E.D. Miss. 1884).

[4] Title 68 O.S. 1981 § 221 provides in pertinent part:

"...(c) Within thirty (30) days after the mailing of the aforesaid proposed assessment, the taxpayer may file with the Tax Commission a written protest under oath, signed by himself or his duly-authorized agent, setting out therein:

(1) A statement of the amount of deficiency as determined by the Tax Commission, the nature of the tax and the amount thereof in controversy;

(2) A clear and concise assignment of each error alleged to have been committed by the Tax Commission;

(3) The argument and legal authority upon which each assignment of error is made; provided, that the applicant shall not be bound or restricted in such hearing, or on appeal, to the

The contention of the protesting savings & loan associations before the Oklahoma Tax Commission was that the income subjected to taxation was either earned on federal obligations or that it was exempt from taxation by controlling federal statutes. After considering this argument, the Oklahoma Tax Commission on May 30, 1985, denied the protests, finding that the income earned on the overnight/demand deposits, the fed-funded transactions in the Federal Home Loan Bank (FHLB),[5] the pre-paid premiums to the Federal Savings and Loan Insurance Corporation (FSLIC), the bonds issued by the Federal National Mortgage Association (FNMA), and the Federal Home Loan Mortgage Corporation (FHLMC) were not federal obligations pursuant to 12 U.S.C. §§ 1433, 1725.[6] The OTC concluded that all the

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arguments and legal authorities contained and cited in said application;

(4) A statement of relief sought by the taxpayer; and

(5) A verification by the taxpayer or his duly authorized agent that the statements and facts contained therein are true . . ."

[5] Federal funds represent member bank deposits at a Federal Reserve Bank. Trading federal funds refers to the sale or the purchase of these deposit balances at rates of interest set by the parties to the trade. Most banks participate in the funds market as either buyers or sellers to maintain their legal reserves at required levels. W. Baughn and C. Walker, *The Bankers' Handbook*, Ch. 37, p. 470-71 (Dow Jones-Irwin 1978).

[6] The tax exemption statute, 12 U.S.C. § 1433 (1957) provides:

"Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital,

income from these sources was subject to state taxation under 12 U.S.C. 1464(h).[7] The savings and loans appealed the

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reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that in any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued by any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any homeowner debtor of such bank."

Title 12 U.S.C. §1725 (1980) provides in pertinent part:

"(e) All notes, bonds, debentures, or other such obligations issued by the Corporation shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The Corporation, including its franchise, capital, reserves, surplus, and income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the Corporation shall be subject to state, territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed . . . .

[7] Title 12 U.S.C. §1464(h) (1980) provides:

"(h) No State, county, municipal, or local taxing authority shall impose any tax on such associations or their franchise, capital, reserves, surplus, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions."

Commission's findings except its finding that the income earned on the fed-funded transactions was taxable.

HISTORY OF THE STATE TAXATION OF FINANCIAL INSTITUTIONS

The first significant controversy involving taxation of banks arose in *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819) when the state of Maryland attempted to tax bank notes issued by the Second Bank of the United States. The United States Supreme Court held that the bank was an instrumentality of the federal government,[8] that taxation of the banks operation would substantially burden governmental activities,[9] that the bank was a necessary and proper incident of the congressional power to lay and collect taxes and to borrow money, that the tax violated the supremacy clause of the United States Constitution,[10] and that the supremacy clause vested Congress with the ability to override state laws in conflict with the exercise of constitutionally delegated congressional powers.

In 1819, the federal reserve system was non-existent, it was uncertain whether the federal government could issue

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[8] See also *Osborn v. Bank of the United States*, 21 U.S. (9 Wheat.) 738, 859-60, 64 L.Ed. 204 (1924).

[9] Symons, "State Taxation of Banks: Federal Limitations", 99 Banking L.J. 817, 821 (1982).

[10] The supremacy clause, U.S. Const. art. VI, cl.2, provides:

> "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

money,[11] and the Second Bank played a major role in the federal government's fiscal and monetary affairs. Nevertheless, the Court recognized that the general power of taxation by the states extends to certain aspects of federal instrumentalities:[12]

> "This opinion does not deprive the States of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the State, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state. But this (tax on note issuance) is a tax on the operations of the bank, and is, consequently, a tax on the operations of an instrument employed by the government of the Union to carry its powers into execution."

The Borrowing[13] and Supremacy clauses of the Constitution do not prohibit the states from taxing personal property representing an interest in a federal instrumentality as long as the property interest is not taxed in a discriminatory manner when compared to similar investment property. This balancing of state and federal powers was the reason for the

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[11] *Julliard v. Greenman*, 110 U.S. 421, 445, 28 L.Ed. 204 (1884); *Legal Tender Cases*, 79 U.S. 457, 547, 20 L.Ed. 894 (1870).

[12] *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 436-37 (1819).

[13] The U.S. Const. art. I, § 8, cl. 1-2 provides:

> "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;
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> To borrow Money on the credit of the United States;"

subsequent enactment of 12 U.S.C. § 548 in 1864, which allowed a bank share tax on national bank stock held in the hands of individuals to be taxed. Even so, the tax could not be levied at a greater rate than that applied to state-chartered banks or other moneyed capital.[14]

In recent years, it has been recognized by Congress that national banks are no longer significant federal instrumentalities, and that general taxation of their activities has little effect on the operation of the federal government's fiscal and monetary affairs.[15] Congress amended § 548[16] in 1969, to permit the general taxation of national banks — limited only by the nondiscrimination requirement relative to state-chartered banks, and possible constitutional requirements under the supremacy and borrowing clauses. The Federal Home Loan Bank Board was established in 1932 by the Federal Home Loan Bank Act.[17] In 1933, the Board was

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[14] Symons, "State Taxation of Banks: Federal Limitations", supra, see note 9. See generally, Cohen, "Federalism in Equality Clothing: A Comment on *Metropolitan Life Insurance Company v. Ward*," 38 Stanford L.Rev. 1 (1985). Moneyed capital is money invested in private banking, investments of individuals in securities that represent money at interest and other evidences of indebtedness that are normal in the business of banking. *Comanche County v. American National Bank*, 122 Okla. 134, 252 P. 408, 410 (1926).

[15] S.Rep. No. 530, 91st Cong. 1st Sess., reprinted in 1969 U.S. Code Cong & Ad News 1594-95.

[16] State taxation is provided in 12 U.S.C. § 548 (1969):

> "For the purposes of any tax law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located."

[17] See 12 U.S.C. § 1421 (1932).

authorized to charter and supervise federal savings and loan associations, local mutual thrift institutions in which people could invest funds to provide financing for homes.[18]

The protestants argue, and correctly so, that the "borrowing clause" of the United States Constitution[19] as well as 31 U.S.C. § 3124,[20] prohibit the state from directly taxing interest on federal obligations. However, the question posed here is whether the assets subjected to taxation qualify for an ex-

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[18] See 12 U.S.C. § 1464 (1980). The section was amended in 1984 with this purpose unchanged.

[19] U. S. Const. art. I, § 8, cl.1-2, see note 13, supra.

[20] Exemption from taxation, 31 U.S.C. § 3124 (1982) provides:

> "(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except —
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> (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
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> (2) an estate or inheritance tax
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> (b) The tax status of interest on obligations and dividends, earnings, or other income from evidence of ownership issued by the Government or an agency and the tax treatment of gain and loss from the disposition of those obligations and evidences of ownership is decided under the Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.). An obligation that the Federal Housing Administration has agreed, under a contract made before March 1, 1941, to issue at a future date, has the tax exemption privileges provided by the authorizing law at the time of the contract. This subsection does not apply to obligations and evidences of ownership issued by the District of Columbia, a territory or possession of the United States, or a department, agency, instrumentality, or political subdivision of the District, territory, or possession."

emption from state tax under either specific statutory or general constitutional principles.

Title 12 U.S.C. § 1464(h)[21] allows states to tax federal savings and loan associations, their franchises, reserves, surplus, loans, and income if the taxation is not greater than that imposed on similar local mutual or cooperative thrift and home financing institutions. In *Sooner Federal Savings and Loan Assoc. v. Oklahoma Tax Commission*, 662 P.2d 1366, 1369 (Okla. 1982) *app. dism'd* April 18, 1983, 103 S.Ct. 1760, this Court, after reviewing § 1464(h) and the case law emanating therefrom, held that the statute supported non-discriminatory state taxation of *all* the income of federal savings and loans.

I

THE INTEREST EARNED ON FHLMC BONDS IS EXEMPT FROM TAXATION.

The FHLMC issued bonds pursuant to 12 U.S.C. § 1455,[22] which provides that if the purchase of the bonds is limited by

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[21] Title 12 U.S.C. § 1464(h) (1980), see note 7, supra.

[22] The issuance of bonds, 12 U.S.C. § 1455 (1979), provides in part:

> "The Corporation is authorized, upon such terms and conditions as it may prescribe, to borrow, to give security, to pay interest or other return, and to issue notes, debentures, bonds, or other obligations, or other securities, including without limitation mortgage-backed securities guaranteed by the Government National Mortgage Association in the manner provided in section 1721(g) of this title. Any obligation or security of the Corporation shall be valid and binding notwithstanding that a person or persons purporting to have executed or attested the same may have died, become under disability, or ceased to hold office or employment before the issuance thereof. . . .

state law, they shall be considered to be an obligation of the United States for purposes of the limitation. Oklahoma does limit the investment in FHLMC stock to 5% of the savings and loan associations assets.[23] The bonds are considered

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(1) Any person, trust, or organization created pursuant to or existing under the laws of the United States or any State shall be authorized to purchase, hold, and invest in mortgages, obligations, or other securities which are or have been sold by the Corporation pursuant to this Section or pursuant to section 1454 of this title to the same extent that such person, trust, or organization is authorized under any applicable law to purchase, hold, or invest in obligations issued by or guaranteed as to principal and interest by the United States or any agency or instrumentality thereof. Where State law limits the purchase, holding, or investment in obligations issued by the United States by such a person, trust, or organization, such Corporation mortgages, obligations, and other securities shall be considered to be obligations issued by the United States for purposes of the limitation. . . ."

[23] Investments in securities are limited in 18 O.S. 1981 § 381.56 which provides in pertinent part:

"Associations shall have power to invest in securities as follows:

1. In obligations of, or obligations which are fully guaranteed as to principal and interest by, the United States or this state; in stock or obligations of any Federal Home Loan Bank or Banks; in stock or obligations of the Federal Savings and Loan Insurance Corporation; and in stock or obligations of the Federal National Mortgage Association or any successor or successors thereto.

2. In time deposits, certificates, accounts, or other obligations of banks or other financial institutions, the accounts of which are insured by the Federal Deposit Insurance Corporation.

3. Not in excess of five percent (5%) of its assets in bonds, notes or other evidences of indebtedness which are a general

obligations of the United States and any interest thereon also would be exempt from taxation.

II

INTEREST RECEIVED FROM THE OVERNIGHT/DEMAND DEPOSITS IS NOT EXEMPT FROM TAXATION

The protestants contend that the overnight/demand deposits are actually loans to the FHLB thereby constituting obligations under 31 U.S.C. § 3124[24] and 12 U.S.C. § 1433. The pertinent portion of § 1433 provides:

> "Any and all notes, debentures, bonds and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation . . ."

The word "obligations" could be interpreted to embrace virtually everything which a bank is bound to pay. We must determine how broadly the "obligations" are to be construed and precisely what income is covered by the exemption. In discerning the scope of the word "obligations," we must bear in mind that the settled rule to construction is that tax

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— obligation of, or guaranteed as to principal and interest by, any agency or instrumentality of the United States not specified in subparagraph 1, or of any city, county or school district in this state. . . ."

This was amended in 1983. Paragraphs one through three remain unchanged.

[24] See note 20, supra.

exemptions are not to be inferred lightly,[25] nor will exemptions be applied unless they are already granted by statute.[26]

Apparently, by using the term "issued", the obligations referred to in the statute are those which might be issued in the exercise of the borrowing power of the United States.[27] The United States Supreme Court's decision in *Hibernia Savings & Loan Society v. San Francisco*, 200 U.S. 310, 315, 26 S.Ct. 265, 50 L.Ed. 495 (1906), is helpful. In question there was the validity of a tax imposed by the State of California on checks or orders signed by the Treasurer of the United States. Section 3701 of the Revised Statutes (31 U.S.C.A. § 742) provided that "stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under state or municipal or local authority."

In *Hibernia*, the Court noted that the basis of this exemption was that a tax upon the obligations of the United States virtually taxes the credit of the Government; that it impairs its power to raise money for the purpose of carrying on its civil and military operations; and that a tax which diminishes, in the slightest degree, the value of the obligations issued by the Government for that purpose impairs *pro tanto* their market value. However, the Court held that although the checks could be considered to be obligations of the United States within the letter of the exemption statute, they were

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[25] *Heiner v. Colonial Trust Co.*, 275 U.S. 232, 235, 48 S.Ct. 65-6, 72 L.Ed. 256, 258 (1927); *Power Equipment Co. v. United States*, 748 F.2d 1130, 1137 (6th Cir. 1984); *United States Trust Co. of New York v. Anderson*, 65 F.2d 575, 577 (2nd Cir. 1933).

[26] *Denman v. Slayton*, 282 U.S. 514, 519, 51 S.Ct. 269, 75 L.Ed. 500, 502 (1931); *Phoenix Insurance Co. v. Tennessee*, 161 U.S. 173, 177, 16 S.Ct. 471, 40 L.Ed. 660 (1896).

[27] *Power Equipment Co. v. United States*, see note 25, supra.

not within its spirit. The court relied on 28 Stat. 278, August 13, 1894, recodified as 31 U.S.C. § 5154 (1983): —

> "A State or a territory or possession of the United States may tax United States coins and currency (including Federal reverve notes and circulating notes of Federal reserve banks and national banks) as money on hand or on deposit in the same way and at the same rate that the State, territory, or possession taxes other forms of money. This section does not affect a law taxing national banks."

"Obligations" as used in an exemption clause when construed with the general purposes of the exemption may not necessarily be all-embracing.[28] The fact that in *Hibernia* the money was deposited in a federal bank and interest was paid to the protestants did not prevent it from becoming a part of the general property of the bank and subject to state taxation.[29] We find that overnight/demand deposits are subject to taxation by the State of Oklahoma.

III

THE INTEREST EARNED ON FNMA BONDS IS TAXABLE.

The savings and loan associations contend that the bonds issued by FNMA are tax exempt. We do not agree. The FNMA is authorized to issue obligations under 12 U.S.C. §1719(b).[30] The authorizing stature requires that bonds is-

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[28] *United States Trust Co. of New York v. Anderson*, see note 25, supra at p. 579.

[29] *Hibernia Savings Society v. San Francisco*, 200 U.S. 311, 316, 26 S.Ct. 265, 50 L.Ed. 495 (1906).

[30] Title 12 U.S.C. §1719(b) (1980) provides in pertinent part:

sued under this section contain language disclaiming that the obligations are not notes or obligations of the United States or any agency other than the issuing corporation. Obviously, the intent of §1719 is that these bonds are not permanent public debts exempt from taxation.

The savings and loan associations rely on *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 398, 103 S.Ct. 692, 74 L.Ed.2d 562, 568 (1983), in which the United States Supreme Court found that the Tennessee bank tax violated the immunity of obligations of the United States from state and local taxation. The tax was held to be discriminatory in favor of securities issued by Tennessee and its political subdivisions.[31] There, the bonds issued by the Federal Farm Credit Banks did not contain the language "not a debt or obligation of the United States," and the Court found that it was an obligation under 31 U.S.C. § 742 because no distinction had been made between the obligations of the United States Treasury and the obligations of the Federal Credit Banks. Here, § 1719 specifically mandates that the bonds issued by FNMA are not obligations of the United States.

The savings and loan associations assert that the state's imposition of a tax on federal obligations but not on state obligations is discriminatory. This appeal involves the threshold question of whether obligations held by appellants consti-

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"... The corporation shall insert appropriate language in all of its obligations issued under this subsection clearly stating that such obligations, together with the interest thereon was not guaranteed by the United States and do not constitute a note or obligations of the United States or of any agency or instrumentality thereof other than the corporation...."

[31] *Metropolitan Life Insurance Co. v. Ward*, 470 U. S. 869, 105 S.Ct. 1676, 84 L.Ed. 2d 751 (1985). See also, Cohen, "Federalism in Equality Clothing: A Comment on *Metropolitan Life Insurance Company v. Ward*," 38 Stanford L.Rev. 1 (1985).

tute obligations of a federal agency qualifying for exemption from state tax under either specific statutory authority or general constitutional principles — the proper classification of the obligations themselves is an issue on appeal. Even so, the issue of discrimination was not raised in the hearing before the Oklahoma Tax Commission and is not properly preserved on appeal.[32] Nevertheless, because the State of Oklahoma taxes neither federal nor state exempted obligations no discrimination is apparent. Title 68 O.S. Supp. 1982 § 2358,[33] specifically provides that income which is exempt under the Federal Constitution, State Constitutional, federal laws or laws of Oklahoma is shielded from taxation. Discrimination is not the issue, the question is whether the bonds are federal obligations and as such are exempt. We find that the FNMA bonds were specifically excluded from obligations of the United States and that the interest is taxable.

IV.

THE INTEREST RECEIVED FROM THE SECONDARY RESERVES IS TAXABLE

The savings and loan associations contend that the interest income earned on the secondary reserve maintained by the FSLIC is not subject to Oklahoma corporate income tax. We disagree. The FSLIC is obligated to insure the accounts of federal savings and loan associations.[34] Insured institutions

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[32] *State v. Tarpenning*, 204 Okla. 181, 228 P.2d 374, 376 (1951).

[33] Title 68 O.S. Supp. 1982 § 2358, provides in pertinent part:

> "... 2. There shall be deducted amounts included in such income that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma. ..."

[34] Title 12 U.S.C. § 1726 (1980) provides in pertinent part:

are charged annual premiums and, at one time, were also required to make contributions to the FSLIC secondary reserve.[35] Since 1973, no prepayments of insurance premiums have been made. The secondary reserve is only available to the FSLIC when losses occur, and then only to the extent other available accounts are insufficient.[36]

"(a) It shall be the duty of the Corporation to insure the accounts of all Federal savings and loan associations and Federal mutual savings banks, and it may insure the accounts of building and loan, savings and loan, and homestead associations and cooperative banks organized and operated according to the laws of the State, District, Territory, or possession in which they are chartered or organized. . . ."

This was amended in 1982, the provision relating to savings and loan associations remains unchanged.

[35] Title 12 U.S.C. § 1727 (1980) provides in pertinent part:

"(a)(1) The Corporation shall establish a primary reserve which shall be the general reserve of the Corporation and a secondary reserve to which shall be credited the amounts of the prepayments made by insured institutions pursuant to former provisions of subsection (d) of this section and the credits made pursuant to the first sentence of subsection (e) of this section. . . ."

(b)(1) Each institution whose application for insurance is approved by the Corporation shall pay to the Corporation, in such manner as it shall prescribe, a premium for such insurance equal to one-twelfth of 1 per centum of the total amount of all accounts of the insured members of such institution. . . ."

[36] The provision for crediting the secondary reserve, 12 U.S.C. § 1727(e) (1980), provides:

"(e) The Corporation shall credit to the secondary reserve, as of the close of each calendar year a return on the outstanding balances of the secondary reserve, during such calendar year, as determined by the Corporation, at a rate equal to the average annual rate of return to the Corporation during the year ending at the close of November 30 of such calendar year,

Each insured institution has a *pro rata* share in the secondary reserve.[37] It is not assignable or transferable except under circumstances set by the FSLIC, e.g., approved mergers, consolidations, or similar situations.[38] A separate account is maintained for each insured institution's share of the secondary reserve and a statement issued annually.[39] The FSLIC uses the funds to pay the savings and loan associations insurance premiums under § 1727(g).[40] An insured institution

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as determined by the Corporation, on the investments held by the Corporation in obligations of, or guaranteed as to principal and interest by, the United States. Except as provided in subsections (f) and (g) of this section, the secondary reserve shall be available to the Corporation only for losses of the Corporation and shall be so available only to such extent as other accounts of the Corporation which are available therefor are insufficient for such losses. No right, title, or interest of any institution in or with respect to its pro rata share of the secondary reserve shall be assignable or transferable whether by operation of law or otherwise, except to such extent as the Corporation may provide for transfer of such pro rata share in cases of merger or consolidation, transfer of bulk assets or assumption of liabilities, and similar transactions, as defined by the Corporation for purposes of this sentence."

[37] *Commissioner v. Lincoln Savings & Loan Assoc.*, 403 U.S. 345, 350, 91 S.Ct. 1893, 29 L.Ed.2d 519, 529 (1971).

[38] See 12 U.S.C. § 1727(e) (1980), note 36, supra.

[39] *Commissioner v. Lincoln Savings & Loan Assoc.*, see note 37, supra.

[40] The payment of the premium is authorized by 12 U.S.C. § 1727(g) (1980) which provides in pertinent part:

"(g) If, at the close of December 31 in any year after 1971, the aggregate of the primary reserve and the secondary reserve equals or exceeds 1¼ per centum of the total amount of all accounts of insured members of all insured institutions but the primary reserve does not equal or exceed 2 per centum of such base, each insured institution's pro rata share of the secondary

may obtain a cash refund of its *pro rata* share if its status as an insured is terminated or upon receivership or liquidation.[41] In *Commissioner v. Lincoln Savings and Loan Association*, 403 U.S. 345, 356, 91 S.Ct. 1893, 29 L.Ed. 519, 528 (1971), the Court recognized that each insured institution has a distinct and recognized property interest in the secondary reserve. The Court also noted that savings and loan associations were required under federal and state requirements to show the interest credited by the FSLIC as an asset on its balance sheet and the credit as income. We, therefore, find that the interest is taxable income, not an exempt obligation.

CONCLUSION

We find that the bonds issued by the Federal Home Loan Mortgage Corporation are exempt from taxation, but that the overnight demand deposits, the bonds issued by the Federal National Mortgage Association, and the interest credited to the FSLIC's secondary reserve are taxable.

AFFIRMED IN PART; REVERSED IN PART

DOOLIN, C.J., HARGRAVE, V.C.J., HODGES, LAVENDER, OPALA, SUMMERS, JJ, concur; SIMMS, J., concurs in Part I, II, IV, dissents from Part III.

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reserve shall, during the year beginning with May 1 next succeeding such close, be used, to the extent available, to discharge such institution's obligation for its premium under subsection (b) of this section for the premium year beginning in such year, . . ."

[41] See 12 U.S.C. §§ 1727(f), 1730 (1980).

BEFORE THE OKLAHOMA TAX COMMISSION

STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF GREAT PLAINS FEDERAL SAVINGS AND LOAN ASSOCIATION, (FORMERLY CUSTER COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION) OF WEATHERFORD, OKLAHOMA, TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED JANUARY 14, 1983.	No. P-83-048

ORDER NO. 85-05-30-07

This matter comes on before the Oklahoma Tax Commission upon the joint Motion to Advance the Cause granted by the duly assigned Administrative Law Judge, Joe Mark Elkouri, in the protest of Great Plains Federal Savings and Loan Association, (formerly Custer County Federal Savings and Loan Association), (Protestant) to the proposed assessment of additional income tax, penalty and interest, for tax years 1980 and 1981, issued January 14, 1983, by the Income Tax Division of the Oklahoma Tax Commission (Division). The Commission proceeded to review the Findings, Conclusions and Recommendations of the Administrative Law Judge, the protest, stipulated facts and documentary evidence and the applicable statutes and caselaw, and being duly advised in the premises, finds:

Part I. The filings and recommendations of the Administrative Law Judge in this matter are proper and should be adopted as findings of the Commission, as though completely set out herein, and specifically that:

1. The Oklahoma Tax Commission has jurisdiction in this matter pursuant to 68 O.S.1981, §§ 207, 221 and 2373.

2. The issue is whether income distributed to or credited to Great Plains Federal Savings and Loan Association (formerly Custer County Federal Savings and Loan Association) of Weatherford, Oklahoma, from the following specified sources is exempted from state taxation by federal law and subsection (A)(2) of § 2358 of Title 68 of the Oklahoma Statutes;

(a) Overnight deposits in the Federal Home Loan Bank, Topeka, Kansas,

(b) Deposits in the FHLB loaned through the federal reserve system (fed-funds),

(c) Premiums prepaid to the Federal Savings and Loan Insurance Corporation and credited to the Secondary Reserve thereof,

(d) Federal National Mortgage Association bonds, and

(e) Federal Home Loan Mortgage Corporation bonds.

3. This protest was properly, in accordance with the laws of this state, advanced to the Commission En Banc upon request of the Protestant and the Division, together with the stipulated record and a proposed Commission order.

4. More than ten (10) days have passed since the mailing of the Findings, Conclusions and Recommendations of the Administrative Law Judge herein and Protestant has not filed any written objection to said Findings, Conclusions and Recommedations with the proposed order attached thereto. The proposed order of the Oklahoma Tax Commission is proper and should be issued.

Part II. The stipulated facts duly admitted into the record by the Administrative Law Judge are:

(1) Great Plains Federal Savings and Loan Association (formerly Custer Federal Savings and Loan Association) of Weatherford, Oklahoma, is, and at all times relevant to the taxable years at issue, has been a federally chartered savings and loan association located and doing business in Weatherford, Oklahoma, hereinafter Protestant.

(2) For each of the relevant taxable years at issue, Protestant has filed the required Oklahoma corporate income tax return and paid all taxes as calculated thereon.

(3) For each of the relevant taxable years at issue, Protestant is a fiscal year taxpayer with a fiscal year ending June 30. The relevant taxable years at issue are Protestant's fiscal years ending June 30, 1980 and June 30, 1981.

(4) The sources and amounts of income at issue received by Protestant during each of the relevant taxable years at issue are:

Source of Income	Amount of Income FYE 6/30/80	FYE 6/30/81
Interest on overnight deposits in the Federal Home Loan Bank, Topeka, Kansas (FHLB)	$14,368.59	$ 13,388.47
Interest on deposits in the FHLB loaned through the federal reserve system (fedfunds)	-0-	$231,046.27
Interest on premiums prepaid to the Federal Savings and Loan Insurance Corporation and credited to the Secondary Reserve	$18,416.41	$ 21,463.75

Source of Income	Amount of Income FYE 6/30/80	FYE 6/30/81
Interest on bonds issued by Federal National Mortgage Association	$89,999.96	$174,062.46
Interest on bonds issued by Federal Home Loan Mortgage Corporation	$22,452.67	-0-

The total income at issue is $585,198.58. The income at issue has not been reported by Protestant as taxable income and income tax thereon has not been paid for the relevant taxable years at issue.

(5) On January 14, 1983, pursuant to an office audit of the corporate income tax returns of Protestant for the relevant taxable years at issue, the Income Tax Division of the Oklahoma Tax Commission (Division) issued its proposed assessment of additional income tax, penalty and interest in the total amount of $36,457.00, for the taxable years ending June 30, 1980 and June 30, 1981. The proposed additional income tax assessed upon the income at issue, exclusive of penalty and interest, for each relevant taxable year is:

	FYE 6/30/80	FYE 6/30/81
Amount of proposed and protested additional income tax	$5,809.51	$17,598.44

(6) Income at issue received by Protestant on overnight deposits with the FHLB represents interest paid by the FHLB, pursuant to arrangements authorized by subsection 1431(e)(1) of Title 12 U.S.C., and by paragraph (b) of section 524.4 of Title 12, Code of Federal Regulations, as in effect during the involved audit period. Deposits in an overnight deposit account with the FHLB are for periods of

24 hours, except weekends, and funds deposited in a FHLB overnight deposit account remain so deposited until withdrawn by the savings and loan association (Protestant). Most frequently, funds are transferred into a FHLB overnight deposit account through commercial bank wire or from a FHLB demand deposit account. Instructions for withdrawals from or deposits into a FHLB overnight account may be made by telephone and, presently, must be received by the FHLB prior to 11:00 o'clock a.m. each day and, must be made in multiples of $25,000.00. The FHLB interest rate paid to a savings and loan association on its overnight deposits is, currently, approximately ⅛ of 1% lower than the daily interest rate on fed-fund transactions. The FHLB assumes liability for the overnight deposit and interest thereon.

(7) Income at issue received by Protestant on FHLB overnight deposits with respect to which the FHLB acts as agent and loans the deposited funds through the federal reserve system, or fed-fund income, represents income paid by the borrower in the transaction. The savings and loan association, on its own initiation, appoints the FHLB to act as its agent in fed-fund transactions and authorizies the FHLB to sell or lend its funds in a FHLB overnight deposit account to a purchaser or borrower. The purchaser or borrower must be a member or participant of the federal reserve system. The term fed-fund transaction, as used herein, is the generic term indicating the lending of money to commercial, financial institutions at current market rates through the federal reserve system. The FHLB assumes no liability for the funds loaned in a fed-fund transaction nor the interest thereon. The FHLB receives no fee or payment otherwise for acting as agent of the savings and loan association in the fed-fund transaction. The request and authorization to the FHLB by the FHLB overnight depositor to loan funds in a fed-fund

transaction is a withdrawal of funds from a FHLB overnight deposit account.

(8) Income at issue received by Protestant on prepaid premiums to the Secondary Reserve of the Federal Savings and Loan Insurance Corporation (FSLIC) represents income paid or credited to Protestant by FSLIC under the provisions of subsection (e) or (i) of section 1727 of Title 12 U.S.C. Protestant is, and has been at all times during its existence, a savings and loan association insured by the FSLIC.

12 U.S.C. § 1727 requires FSLIC to establish and maintain two reserves: a Primary Reserve, as the general reserve, and a Secondary Reserve. Prior to August 16, 1973, all prepaid insurance premiums made to the FSLIC by Protestant were, under the authority of paragraph (1) of subsection (a) of § 1727, credited by the FSLIC to a secondary reserve. No prepayments of insurance premiums have been made since August 16, 1973.

The net income or retained earnings of the FSLIC are annually credited to the Primary Reserve; that is, the excess of the regular premium payment (not the additional or prepaid premium) over and above the insurance losses and FSLIC expenses is placed in the Primary Reserve.

The Secondary Reserve is separate and distinct from the Primary Reserve. Each insured savings and loan association has a pro rata share in the Secondary Reserve, and FSLIC maintains a separate account for each insured savings and loan association's share of the Secondary Reserve. Each insured has a distinct and recognized property interest in the Secondary Reserve which is transferable or assignable for approved mergers, consolidations or other similar situations. Upon termination of the insured status or upon receivership or liquidation, the insured is entitled to a cash refund of its pro rata share of the Secondary Reserve.

The Secondary Reserve consists of the additional premiums and the annual return on the outstanding balance calculated at a rate equal to the average annual rate of return on investments held by the FSLIC, subsection (e) of §1727. The return is annually credited to the separate account of each insured's share of the Secondary Reserve.

The aggregate of the Primary and Secondary Reserves equals or exceeds 2% of all accounts and creditor obligations of all insured savings and loan associations of the FSLIC administered and controlled by the FHLB-Topeka, Kansas and no prepaid premiums or additional premiums have been paid by the insureds since August 16, 1973.

(9) Income at issue received by Protestant on bonds issued by the Federal National Mortgage Association represents interest paid by the Association on bonds owned by the Protestant and issued by the Federal National Mortgage Association under the authority of subsection 1719(b) of Title 12 U.S.C.

(10) Income at issue received by Protestant on bonds issued by the Federal Home Loan Mortgage Corporation represents interest paid by the Corporation on bonds owned by the Protestant and issued by the Federal Home Loan Mortgage Corporation under the authority of subsection 1455(a) of Title 12 U.S.C.

(11) Protestant expressly concedes that dividends received by it on stock of a federal home loan bank are properly subject to the Oklahoma corporate income tax. The Division expressly concedes that interest received by protestant on consolidated bonds issued by federal home loan banks is not properly subject to the Oklahoma corporate income tax.

Part III. Legal authorities applicable to the stipulated facts and evidence set out above are:

(1) The protestant asserts that income earned on overnight deposits and fed-fund transactions in the Federal Home Loan Bank is exempt from state income tax by 12 U.S.C. § 1433 and *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission,* 365 U.S. 517, 81 S.Ct. 719 (1961); that income earned on prepaid premiums deposited to the secondary reserve of the Federal Savings and Loan Insurance Corporation is exempt from state income tax by "... express statutory exemption contained in the enabling statutes of that agency, ..." and the rationale of *Laurens,* supra; and, that interest income from bonds issued by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation is exempt from state income tax by "... proper interpretation of the enabling statute ... and under a long line of decisions by the United States Supreme Court interpreting and construing the doctrine of implied immunity and the supremacy and borrowing clauses ..." *Farmers and Mechanics Savings Bank v. Minnesota,* 232 U.S. 516 (1914) and *Pittman v. Home Owners Loan Corp.,* 308 U.S. 21 (1939).

(2) The authorities cited by Protestant do not support the claimed exemption from state income taxation. The income at issue is income to Protestant, a federally chartered savings and loan association. Congress authorized state taxation of income of savings and loan associations chartered by the United States in 12 U.S.C. § 1464, subsection (h), thus the implied immunity doctrine is inapposite. *Sooner Federal Savings and Loan Association et al v. Oklahoma Tax Commission,* 662 P.2d 1366 (Okl. 1982), appeal dismissed 103 S.Ct. 1760 (1983).

The supremacy and borrowing clauses of the United States Constitution are inapposite inasmuch as there is no federal statute which exempts all or a portion of the income at issue from state income tax. Neither 31 U.S.C. § 1024, formerly 12 U.S.C. § 742, generally exempting obligations of the United States, principal and interest, from state taxation except as therein specified, nor 12 U.S.C., § 1433, exempting income of the Federal Home Loan Bank from state taxation, nor 12 U.S.C. § 1452, exempting income of the Federal Savings and Loan Insurance Corporation from state taxation, nor 12 U.S.C. § 1723a, exempting income of the Federal National Mortgage Association from state taxation, exempts income distributed to or credited to Protestant by such entities from state income tax. *Sooner Federal Savings and Loan Association, et al v. Oklahoma Tax Commission*, supra.

(3) In *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission*, supra, and *Pittman v. Home Owners' Loan Corporation*, supra, the challenged documentary stamp taxes were found to be levied upon necessary functions going to the very purpose for the existence of the federal home loan bank and having the potential to increase the rates of loans to homeowners. *Laurens*, supra, and *Pittman*, supra, each involved documentary stamp tax on instruments executed by federal savings and loan associations to protect the federal home loan bank or its predecessor, the Home Owners' Loan Corporation. In *Pittman*, supra, the Court pointed out that the recording was required for the protection of the Home Owners' Loan Corporation and held, as in *Laurens*, supra, that the tax was upon an indispensable function. In *Laurens*, supra, the Court struck down the tax because it imposed a burden on the lending operations which are protected by Congress.

These two cases held that a state tax levied upon either a federal home loan bank or an intermediary for the recording of mortgages or executing of notes was invalid as being a tax on a government instrumentality. In both cases, the Court considered the taxed activities to be indispensable elements of the lending operation required for the protection of the lending institution.

In this case of an income tax imposed by Oklahoma upon the intermediary, there is no activity and no showing of any activity being taxed which is an indispensable element of the functioning of either the Federal Home Loan Bank, the Federal Savings and Loan Insurance Corporation, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association. The Oklahoma income tax is not upon advances, which was the situation in *Pittman*, supra, nor is it a tax on promissory notes executed by member banks thus affecting the basic functions of the home loan bank, as was the situation in *Laurens*, supra. The Oklahoma income tax does not, in any way, interfere with any of the indispensable elements of the functions of Protestant, as in the *Pittman*, supra, case. Nor does the Oklahoma tax interfere with the basic reason for the exemption, as manifested by the "Act's overall policy of making . . . mortgage funds available at low costs to home owners," as in the *Laurens*, supra, case.

(4) In *Farmers & Mechanics Savings Bank of Minneapolis v. Minnesota*, 232 U.S. 516, 34 S.Ct. 354 (1914), the challenged property tax was found to be imposed upon bonds issued by municipalities created by the Indian (or Oklahoma) territory, an instrumentality of the United States, for public and governmental purposes only. The high court found the tax to be upon the operations of government. 12 U.S.C. § 1464(h) specifically permits the states to impose a nondiscriminatory tax upon the income of Protestant, thus, the *Farmers &*

Mechanics Savings Bank case does not support the claimed exemption.

(5) In *Sooner Federal Savings and Loan Association, et al v. Oklahoma Tax Commission*, supra, the protesting federally chartered savings and loan associations asserted that 12 U.S.C. § 1433 and 12 U.S.C. § 742 and the doctrine of federal instrumentality prohibited the imposition of the Oklahoma income tax upon dividends earned on stock issued by the Federal Home Loan Bank in Topeka, Kansas. In holding that the dividend income was not exempted by Congress from state taxation, the Oklahoma Supreme Court found that the dividends, once distributed by the Federal Home Loan Bank, were income in the hands of the savings and loan associations and were subject to Oklahoma income tax. As in the *Sooner Federal* case, supra, income in the hands of each of the involved distributing entities is specifically exempted from state taxation by federal statute, however, once the income is distibuted to or credited to Protestant, it is subject to inclusion as part of Protestant's Oklahoma taxable income.

(6) By federal statute, the sources of the income at issue are expressly declared not to be obligations of the United States and thus are not exempted from state income tax by 31 U.S.C. § 1024. 12 U.S.C. § 1435 declares that obligations of the Federal Home Loan Banks are not obligations of the United States. 12 U.S.C. § 1719(b) declares that Federal National Mortgage Association obligations and interest thereon are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality other than the Association.

(7) The United States Supreme Court has defined an obligation of the United States which is protected from state taxation, both as to principle and interest, as a credit instrument characterized by (1) written document, (2) the bearing

of interest, (3) a binding promise of the United States to pay specified sums at specified dates; and (4) issued pursuant to specific Congressional authorization which also pledges the full faith and credit of the United States in support of the promise to pay. *Smith v. Davis*, 323 U.S. 111, 65 S.Ct. 157 (1944); *Hibernia Savings and Loan Association v. San Francisco*, 200 U.S.310, 26 S.Ct. 265 (1906).

(8) In *Commissioner of Internal Revenue v. Lincoln Savings and Loan Association*, 403 U.S. 345, 91 S.Ct. 1893 (1971), the United States Supreme Court held that the federally chartered savings and loan associations share of the Secondary Reserve of the Federal Savings and Loan Insurance Corporation is income-producing and the income inures to the benefit of the insured association.

The Court relied upon, as a controlling factor, the fact that the payment serves to create or enhance for the association what is essentially a separate and distinct additional asset, which, as an inevitable consequence, is capital in nature.

The Court stated, at page 335:

> B. The insured institution has a distinct and recognized property interest in the Secondary Reserve. This is revealed by: (1) The recognition, in § 404(e), of transferability of the institution's pro rata share therein. This transferability is limited and restricted, to be sure, but it exists for approved situations of merger, consolidation, and the like. (2) The prospective refund, and in cash at that, of the institution's pro rata share upon termination of its insured status, or upon receivership or liquidation, or when the Primary Reserve alone reaches the suspension level. (3) The use of the institution's pro rata share to pay its basic premium under § 404(b)(1) when the suspension level is reached by the aggregate of the Primary and Secondary Reserves. (4) FSLIC's mainte-

nance of a separate account for each insured institution's share in the Secondary Reserve. (5) The statutorily required annual credit from FSLIC's earnings to the institution's share of the Secondary Reserve. The share thus is an income-producing entity and the income inures to the benefit of the insured institution.

And, in the case of *Bell Federal Savings and Loan Association v. Department of Revenue,* 111 Ill. App. 3d 890 (1982), income earned on prepaid premiums deposited in the secondary reserve of the FSLIC was held to be taxable by the State of Illinois.

(9) We specifically find that income earned on overnight deposits and fed-fund transactions in the Federal Home Loan Bank, Topeka, Kansas, is income earned on a property right of Protestant; that the deposits are not an obligation of the Federal Home Loan Bank, the income of which is exempted under 12 U.S.C. § 1433; that it is income subject to taxation as authorized in 12 U.S.C. § 1464(h); and, that the income is not earned on an obligation of the United States.

(10) We specifically find that income earned on premiums prepaid to the Federal Savings and Loan Insurance Corporation and credited to its Secondary Reserve is income earned on a property right of the Protestant; that the prepaid premium is not an obligation of the Federal Savings and Loan Insurance Corporation, the income of which is exempted under 12 U.S.C. § 1725; that it is income subject to taxation as authorized in 12 U.S.C.§ 1464(h); and, that the income is not earned on an obligation of the United States.

(11) We specifically find that income earned on bonds issued by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation is income earned on property rights of Protestant; that it is income subject to

state taxation as authorized in 12 U.S.C. § 1464(h); and, that the income is not income earned on obligations of the United States.

THEREFORE, IT IS HEREBY ORDERED by the Oklahoma Tax Commission that the protest of Great Plains Federal Savings and Loan Association (formerly Custer County Federal Savings and Loan Association) of Weatherford, Oklahoma to the proposed assessment of additional income tax issued February 1, 1983, be, and the same is hereby denied.

Dated this May 30, 1985.

(SEAL)

OKLAHOMA TAX COMMISSION

ATTEST:

JO ELLEN CORBIN
Assistant Secretary

ODIE A. NANCE
Odie A. Nance, Chairman

APPROVED:

JERRY R. GOLDEN
Jerry R. Golden, Director Income Tax Division

ROBERT L. WADLEY
Robert L. Wadley, Vice-Chairman

DON KILPATRICK
Don Kilpatrick Secretary-Member

APPROVED AS TO FORM:

J. LAWRENCE BLANKENSHIP
General Counsel

DONNA E. COX
Attorney

MARJORIE L. WELCH
Attorney

CHRISTY J. CAESAR
Attorney

I do hereby certify that the above and foregoing is a true copy of the original document now on file in my office. Witness my hand and official seal of The Oklahoma Tax Commission, this May 30, 1985.

Don Kilpatrick, Secretary

By JOE ELLEN CORBIN
Assistant Secretary
Oklahoma Tax Commission

Case No. P-83-048

Great Plains Federal Savings & Loan Association
v. Oklahoma Tax Commission

CERTIFICATE OF MAILING

I hereby certify that a certified copy of the above and foregoing Order was mailed with sufficient postage prepaid to Great Plains Federal Savings and Loan Association, P. O. Box 271, Weatherford, Oklahoma, 73096, and a copy to Mr. Dee A. Replogle, Jr., McAfee and Taft, One Hundred Park Avenue, Oklahoma City, Oklahoma, 73102.

Dated this 31st day of May, 1985.

CECIL JOHNSTON

ORDER NO. 85-05-30-07

BEFORE THE OKLAHOMA TAX COMMISSION
STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLAREMORE, OKLAHOMA, TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED DECEMBER 7, 1982.

No. P-83-039

ORDER NO. 85-05-30-08

This matter comes on before the Oklahoma Tax Commission upon the joint Motion to Advance the Cause granted by the duly assigned Administrative Law Judge, Joe Mark Elkouri, in the protest of First Federal Savings and Loan Association of Claremore, Oklahoma, (Protestant) to the proposed assessment of additional income tax, penalty and interest, for tax years 1979, 1980, and 1981, issued December 7, 1982, by the Income Tax Division of the Oklahoma Tax Commission (Division). The Commission proceeded to review the Findings, Conclusions and Recommendations of the Administrative Law Judge, the protest, stipulated facts and documentary evidence and the applicable statutes and caselaw, and being duly advised in the premises, finds:

Part I. The findings and recommendations of the Administrative Law Judge in this matter are proper and should be adopted as findings of the Commission, as though completely set out herein, and specifically that:

1. The Oklahoma Tax Commission has jurisdiction in this matter pursuant to 68 O.S.1981, §§ 207, 221 and 2373.

2. The issue is whether income distributed to First Federal Savings and Loan Association of Claremore, Oklahoma from the following specified sources is exempted from state taxa-

tion by federal law and subsection (A)(2) of § 2358 of Title 68 of the Oklahoma Statutes;

(a) Overnight deposits in the Federal Home Loan Bank, Topeka, Kansas,

(b) Deposits in the FHLB loaned through the federal reserve system (fed-funds), and

(c) Federal National Mortgage Association bonds.

3. This protest was properly, in accordance with the laws of this state, advanced to the Commission En Banc upon request of the Protestant and the Division, together with the stipulated record and a proposed Commission order.

4. More than ten (10) days have passed since the mailing of the Findings, Conclusions and Recommendations of the Administrative Law Judge herein and Protestant has not filed any written objection to said Findings, Conclusions and Recommendations with the proposed order attached thereto, except as to the fiscal year of the taxpayer. The proposed order, as corrected, is proper and should be issued.

Part II. The stipulated facts duly admitted into the record by the Administrative Law Judge are:

(1) First Federal Savings and Loan Association of Claremore, Oklahoma, is, and at all times relevant to the taxable years at issue, has been a federally chartered savings and loan association located and doing business in Claremore, Oklahoma, hereinafter Protestant.

(2) For each of the relevant taxable years at issue, Protestant has filed the required Oklahoma corporate income tax return and paid all taxes as calculated thereon.

(3) For each of the relevant taxable years at issue, Protestant is a fiscal year taxpayer with a fiscal year ending June 30.

The relevant taxable years at issue are Protestant's fiscal years ending June 30, 1979, June 30, 1980, and June 30, 1981.

(4) The sources and amounts of income at issue received by Protestant during each of the relevant taxable years at issue are:

	Amounts of Income		
	FYE 6/30/79	FYE 6/30/80	FYE 6/30/81
Source of Income			
Interest on overnight deposits in the Federal Home Loan Bank, Topeka, Kansas (FHLB)	$33,533.48	$55,408.35	$58,780.20
Interest on deposits in the FHLB loaned through the federal reserve system (fed-funds)	-0-	$ 1,991.76	$97,760.46
Interest on bonds issued by Federal National Mortgage Association	$ 7,127.97	$ 8,201.16	$ 8,201.28

The total income at issue is $271,004.66. The income at issue has not been reported by Protestant as taxable income and income tax thereon has not been paid for the relevant taxable years at issue.

(5) On December 7, 1982, pursuant to an office audit of the corporate income tax returns of Protestant for the relevant taxable years at issue, the Income Tax Division of the Oklahoma Tax Commission (Division) issued its proposed assessment of additional income tax, penalty and interest in the total amount of $9,102.00, for the taxable years ending June 30, 1979, June 30, 1980, and June 30, 1981. The proposed additional income tax assessed upon the income at issue,

exclusive of penalty and interest, for each relevant taxable year is:

Amount of proposed and protested additional income tax	FYE 6/30/79	$1,730.00
	FYE 6/30/80	$2,625.00
	FYE 6/30/81	$3,773.00

(6) Income at issue received by Protestant on overnight deposits with the FHLB represents interest paid by the FHLB, pursuant to arrangements authorized by subsection 1431(e)(1) of Title 12 U.S.C., and by paragraph (b) of section 524.4 of Title 12, Code of Federal Regulations, as in effect during the involved audit period. Deposits in an overnight deposit account with the FHLB are for periods of 24 hours, except weekends, and funds deposited in a FHLB overnight deposit account remain so deposited until withdrawn by the savings and loan association (Protestant). Most frequently, funds are transferred into a FHLB overnight deposit account through commercial bank wire or from a FHLB demand deposit account. Instructions for withdrawals from or deposits into a FHLB overnight account may be made by telephone and, presently, must be received by the FHLB prior to 11:00 o'clock a.m. each day and, must be made in multiples of $25,000.00. The FHLB interest rate paid to a savings and loan association on its overnight deposits is, currently, approximately ⅛ of 1% lower than the daily interest rate on fed-fund transactions. The FHLB assumes liability for the overnight deposit and interest thereon.

(7) Income at issue received by Protestant on FHLB overnight deposits with respect to which the FHLB acts as agent and loans the deposited funds through the federal reserve system, or fed-fund income, represents income paid by the borrower in the transaction. The savings and loan association, on its own initiation, appoints the FHLB to act as its agent in

fed-fund transactions and authorizies the FHLB to sell or lend its funds in a FHLB overnight deposit account to a purchaser or borrower. The purchaser or borrower must be a member or participant of the federal reserve system. The term fed-fund transaction, as used herein, is the generic term indicating the lending of money to commercial, financial institutions at current market rates through the federal reserve system. The FHLB assumes no liability for the funds loaned in a fed-fund transaction nor the interest thereon. The FHLB receives no fee or payment otherwise for acting as agent of the savings and loan association in the fed-fund transaction.

(8) Income at issue received by Protestant on bonds issued by the Federal National Mortgage Association represents interest paid by the Association on bonds owned by the Protestant and issued by the Federal National Mortgage Association under 12 U.S.C. § 1719(b).

(9) Protestant concedes that dividends received by it on stock of a federal home loan bank are properly subject to the Oklahoma corporate income tax and has not protested a previously claimed and disallowed deduction of $6,513 for 'New Jobs Credit' for its fiscal year ended 6/30/81.

Part III. Legal authorities applicable to the stipulated facts and evidence set out above are:

(1) The protestant asserts that income earned on overnight deposits and fed-fund transactions in the Federal Home Loan Bank is exempt from state income tax by 12 U.S.C. § 1433 and *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission*, 365 U.S. 517, 81 S.Ct. 719 (1961); and, that interest income from bonds issued by the Federal National Mortgage Association is exempt from state income tax by "... proper interpretation of the enabling statute ... and under a long line of decisions by the United

States Supreme Court interpreting and construing the doctrine of implied immunity and the supremacy and borrowing clauses . . . " *Farmers and Mechanics Savings Bank v. Minnesota*, 232 U.S. 516 (1914) and *Pittman v. Home Owners Loan Corp.*, 308 U.S. 21 (1939).

(2) The authorities cited by Protestant do not support the claimed exemption from state income taxation. The income at issue is income to Protestant, a federally chartered savings and loan association. Congress authorized state taxation of income of savings and loan associations chartered by the United States in 12 U.S.C. § 1464, subsection (h), thus the implied immunity doctrine is inapposite. *Sooner Federal Savings and Loan Association et al v. Oklahoma Tax Commission*, 662 P.2d 1366 (Okl. 1982), appeal dismissed 103 S.Ct. 1760 (1983).

The supremacy and borrowing clauses of the United States Constitution are inapposite inasmuch as there is no federal statute which exempts all or a portion of the income at issue from state income tax. Neither 31 U.S.C. § 1024, formerly 12 U.S.C. § 742, generally exempting obligations of the United States, principal and interest, from state taxation except as therein specified, nor 12 U.S.C., § 1433, exempting income of the Federal Home Loan Bank from state taxation, nor 12 U.S.C. § 1723a, exempting income of the Federal National Mortgage Association from state taxation, exempts income distributed to Protestant by such entities from state income tax. *Sooner Federal Savings and Loan Association, et al v. Oklahoma Tax Commission*, supra.

(3) In *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission*, supra, and *Pittman v. Home Owners' Loan Corporation*, supra, the challenged documentary stamp taxes were found to be levied upon necessary functions going to the very purpose for the existence of the

federal home loan bank and having the potential to increase the rates of loans to homeowners. *Laurens*, supra, and *Pittman*, supra, each involved documentary stamp tax on instruments executed by federal savings and loan associations to protect the federal home loan bank or its predecessor, the Home Owners' Loan Corporation. In *Pittman*, supra, the Court pointed out that the recording was required for the protection of the Home Owners' Loan Corporation and held, as in *Laurens*, supra, that the tax was upon an indispensable function. In *Laurens*, supra, the Court struck down the tax because it imposed a burden on the lending operations which are protected by Congress.

These two cases held that a state tax levied upon either a federal home loan bank or an intermediary for the recording of mortgages or executing of notes was invalid as being a tax on a government instrumentality. In both cases, the Court considered the taxed activities to be indispensable elements of the lending operation required for the protection of the lending institution.

In this case of an income tax imposed by Oklahoma upon the intermediary, there is no activity and no showing of any activity being taxed which is an indispensable element of the functioning of either the Federal Home Loan Bank or the Federal National Mortgage Association. The Oklahoma income tax is not upon advances, which was the situation in *Pittman*, supra, nor is it a tax on promissory notes executed by member banks thus affecting the basic functions of the home loan bank, as was the situation in *Laurens*, supra. The Oklahoma income tax does not, in any way, interfere with any of the indispensable elements of the functions of Protestant, as in the *Pittman*, supra, case. Nor does the Oklahoma tax interfere with the basic reason for the exemption, as manifested by the "Act's overall policy of making . . . mort-

65,545 Mary Edna Lolmaugh by and through her Conservator, City National Bank & Trust Company of Guymon, Oklahoma v. First Variable Life Insurance Company.
Certiorari denied.
CONCUR: Doolin, C.J., Hodges, Lavender, Simms, Opala, Summers, JJ.
DISSENT: Hargrave, V.C.J., Wilson, Kauger, JJ.

66,349 George A. Carlyle v. Southern Wings, Inc. and Steven Dyer d/b/a G & S Aircraft and G & S Engines.
Certiorari denied.
CONCUR: Doolin, C.J., Hargrave, V.C.J., Hodges, Lavender, Simms, Opala, Summers, JJ.
DISSENT: Wilson, Kauger, JJ.

68,756 (consolidated with 68,757, 68,758, 68,760) CONOCO, Inc. et al. v. The Corporation Commission of Oklahoma et al.
Order of September 22, 1987, setting oral argument is withdrawn. Oral argument will be set at a date following the completion of the briefing cycle.
CONCUR: Doolin, C.J., Hargrave, V.C.J., Lavender, Simms, Opala, Wilson, Kauger, Summers, JJ.

69,306 Lutheran Social Services, Inc. and The Unknown Family v. The Hon. Thomas C. Smith, Jr., Special District Judge for the Seventh Judicial District, Oklahoma County, State of Oklahoma.
Application to assume original jurisdiction denied.
CONCUR: Hodges, Opala, Wilson, Kauger, Summers, JJ.
DISSENT: Doolin, C.J., Hargrave, V.C.J., Lavender, Simms, JJ.

JACK B. DOOLIN
Chief Justice

gage funds available at low costs to home owners," as in the *Laurens*, supra, case.

(4) In *Farmers & Mechanics Savings Bank of Minneapolis v. Minnesota*, 232 U.S. 516, 34 S.Ct. 354 (1914), the challenged property tax was found to be imposed upon bonds issued by municipalities created by the Indian (or Oklahoma) territory, an instrumentality of the United States, for public and governmental purposes only. The high court found the tax to be upon the operations of government. 12 U.S.C. § 1464(h) specifically permits the states to impose a nondiscriminatory tax upon the income of Protestant, thus, the *Farmers & Mechanics Savings Bank* case does not support the claimed exemption.

(5) In *Sooner Federal Savings and Loan Association, et al v. Oklahoma Tax Commission*, supra, the protesting federally chartered savings and loan associations asserted that 12 U.S.C. § 1433 and 12 U.S.C. § 742 and the doctrine of federal instrumentality prohibited the imposition of the Oklahoma income tax upon dividends earned on stock issued by the Federal Home Loan Bank in Topeka, Kansas. In holding that the dividend income was not exempted by Congress from state taxation, the Oklahoma Supreme Court found that the dividends, once distributed by the Federal Home Loan Bank, were income in the hands of the savings and loan associations and were subject to Oklahoma income tax. As in the *Sooner Federal* case, supra, income in the hands of each of the involved distributing entities is specifically exempted from state taxation by federal statute, however, once the income is distributed to Protestant, it is subject to inclusion as part of Protestant's Oklahoma taxable income.

(6) By federal statute, the sources of the income at issue are expressly declared not to be obligations of the United States and thus are not exempted from state income tax by

31 U.S.C. § 1024. 12 U.S.C. § 1435 declares that obligations of the Federal Home Loan Banks are not obligations of the United States. 12 U.S.C. § 1719(b) declares that Federal National Mortgage Association obligations - and interest thereon are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality other than the Association.

(7) The United States Supreme Court has defined an obligation of the United States which is protected from state taxation, both as to principle and interest, as a credit instrument characterized by (1) written document, (2) the bearing of interest, (3) a binding promise of the United States to pay specified sums at specified dates; and (4) issued pursuant to specific Congressional authorization which also pledges the full faith and credit of the United States in support of the promise to pay. *Smith v. Davis*, 323 U.S. 111, 65 S.Ct. 157 (1944) *Hibernia Savings and Loan Association v. San Francisco*, 200 U.S. 310, 26 S.Ct. 265 (1906).

(8) We specifically find that income earned on overnight deposits and fed-fund transactions in the Federal Home Loan Bank, Topeka, Kansas, is income earned on a property right of Protestant; that the deposits are not obligations of the Federal Home Loan Bank, the income of which is exempted under 12 U.S.C. § 1433; that it is income subject to taxation as authorized in 12 U.S.C. § 1464(h); and, that the income is not earned on an obligation of the United States.

(9) We specifically find that income earned on bonds issued by the Federal National Mortgage Association, is income earned on property rights of Protestant; that it is income subject to state taxation as authorized in 12 U.S.C. § 1464(h); and, that the income is not income earned on obligations of the United States.

THEREFORE, IT IS HEREBY ORDERED by the Oklahoma Tax Commission the protest of First Savings and Loan Association of Claremore, Oklahoma to the proposed assessment of additional income tax issued December 7, 1982, be, and the same is hereby denied.

Dated this May 30, 1985.

(SEAL)

ATTEST:

JO ELLEN CORBIN
Assistant Secretary

OKLAHOMA TAX COMMISSION

ODIE A. NANCE
Odie A. Nance,
Chairman

APPROVED:

ROBERT L. WADLEY
Robert L. Wadley,
Vice-Chairman

JERRY R. GOLDEN
Jerry R. Golden, *Director*
Income Tax Division

DON KILPATRICK
Don Kilpatrick,
Secretary-Member

APPROVED AS TO FORM:

J. Lawrence Blankenship
General Counsel

DONNA E. COX
Donna E. Cox
Attorney

MARJORIE L. WELCH
Marjorie L. Welch
Attorney

CHRISTY J. CAESAR
Christy J. Caesar
Attorney

I do hereby certify that the above and foregoing is a true copy of the original document now on file in my office. Witness my hand and official seal of The Oklahoma Tax Commission, this May 30, 1985.

Don Kilpatrick, Secretary

By JO ELLEN CORBIN
Assistant Secretary
Oklahoma Tax Commission

Case No. P-83-039

First Federal Savings and Loan Association
v. Oklahoma Tax Commission

CERTIFICATE OF MAILING

I hereby certify that a certified copy of the above and foregoing Order was mailed with sufficient postage prepaid to First Federal Savings and Loan Association of Claremore, P. O. Box 888, Claremore, Oklahoma, 74017, and a copy to Mr. Dee A. Replogle, Jr., McAfee and Taft, One Hundred Park Avenue, Oklahoma City, Oklahoma, 73102.

Dated this 31st day of May, 1985.

CECIL JOHNSTON

ORDER NO. 85-05-30-08

BEFORE THE OKLAHOMA TAX COMMISSION

STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLAREMORE, OKLAHOMA, TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED DECEMBER 7, 1982.	No. P-83-039

ORDER NUNC PRO TUNC NO. 85-05-30-39

THIS matter came on before the Oklahoma Tax Commission upon the application of the Legal Division of the Oklahoma Tax Commission for an Order Nunc Pro Tunc correcting an error in Order No. 85-05-30-08 issued on the 30th day of May, 1985. The Commission proceeded to review the files and records in this matter, and being fully advised in the premises, finds:

(1) Order No. 85-05-30-08, issued May 30, 1985, adopted the Findings of Fact and Conclusions of Law of the Administrative Law Judge on this matter; more specifically that: interest income on overnight deposits and fed-fund transactions and interest income on bonds issued by Federal National Mortgage Association are subject to state income tax.

(2) Order No. 85-05-30-08 was inadvertently stamped with the wrong order number;

(3) That Order No. 85-05-30-08 should have been issued as Order No. 85-05-30-39;

(4) Said Order No. 85-05-30-08 should be corrected and issued as Order No. 85-05-30-39.

NOW, THEREFORE, IT IS ORDERED by the Oklahoma Tax Commission that the Order issue number in Order No. 85-05-30-08, issued on the 30th day of May, 1985, be corrected to read as "Order No. 85-05-30-39."

Dated this Jun 06 1985.

(SEAL)

ATTEST:

JO ELLEN CORBIN
Assistant Secretary

APPROVED:

JERRY R. GOLDEN
Jerry Golden, *Director*

APPROVED AS TO FORM:

CHRISTY J. CAESAR
Christy J. Caesar
Attorney

PAUL A. SCOTT
Paul A. Scott
Legal Research Assistant

OKLAHOMA TAX COMMISSION

ODIE A. NANCE
Odie A. Nance,
Chairman

ROBERT L. WADLEY
Robert L. Wadley,
Vice Chairman

DON KILPATRICK
Don Kilpatrick,
Secretary-Member

I do hereby certify that the above and foregoing is a true copy of the original document now on file in my office. Witness my hand and official seal of The Oklahoma Tax Commission, this Jun 06 1985.

Don Kilpatrick, Secretary

By JOE ELLEN CORBIN
Assistant Secretary
Oklahoma Tax Commission

ORDER NUNC PRO TUNC NO. 85-05-30-39

CASE NO. P-83-039
Protest of First Federal Savings and Loan Association of Claremore, Oklahoma.

CERTIFICATE OF SERVICE OR MAILING

I hereby certify true copies of this Order Nunc Pro Tunc were mailed by certified mail, or delivered by hand, to:

Jerry Golden, Director
Income Tax Division
Oklahoma Tax Commission
2501 Lincoln Boulevard
Oklahoma City, Oklahoma 73194

First Federal Savings and Loan Association of Claremore
P. O. Box 888
Claremore, Oklahoma 74017

Mr. Dee A. Replogle, Jr.
McAfee & Taft
One Hundred Park Avenue
Oklahoma City, Oklahoma 73102

DATED this 10th day of June, 1985.

CECIL JOHNSTON

ORDER NUNC PRO TUNC NO. 85-05-30-39

IN THE SUPREME COURT OF
THE STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLAREMORE, OKLAHOMA TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED DECEMBER 7, 1982,

Appellant,

and

IN THE MATTER OF THE PROTEST OF GREAT PLAINS FEDERAL SAVINGS AND LOAN ASSOCIATION, (FORMERLY CUSTER COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION) OF WEATHERFORD, OKLAHOMA, TO THE PROPOSED ASSESSMENT OF ADDITIONAL INCOME TAX ISSUED JANUARY 14, 1983,

Appellant,

v.

OKLAHOMA TAX COMMISSION,

Appellee.

No. 64,673
(cons.w/64,674

For Official Publication

ORDER

IT IS ORDERED that the opinion of this Court filed on May 26, 1987, is hereby modified to show the following change in the vote:

Doolin, C.J., Hodges, Opala, Kauger and Summers, JJ., concur; Lavender and Hargrave, JJ., concur in part, dissent in part; Simms, J., concurs in Parts I, II, IV, dissents from Part III.

DONE BY ORDER OF THE SUPREME COURT IN CONFERENCE THIS 5th DAY OF OCTOBER, 1987.

JACK B. DOOLIN
Chief Justice

IN THE SUPREME COURT OF
THE STATE OF OKLAHOMA

Wednesday, October 7, 1987

The clerk is directed to issue the following orders:

57,337 Donald L. Schaeffer and Jo Ann Schaeffer v. Cecil Shaeffer, an individual.
Rehearing denied; appellants' motion for appeal-related counsel fee and costs is granted and the amount of the fee to be awarded shall be determined by the trial court.
CONCUR: Doolin, C.J., Hargrave, V.C.J., Hodges, Lavender, Opala, Kauger, JJ.
DISSENT: Simms, Wilson, JJ.

63,179 In the Matter of the Estate of Paul J. Speake, Jr., Deceased.
Rehearing denied.
CONCUR: Doolin, C.J., Hargrave, V.C.J., Lavender, Simms, Opala, Wilson, JJ.
DISSENT: Hodges, Kauger, JJ.

64,673 (consolidated with 64,674) First Federal Savings & Loan Association of Claremore, Oklahoma et al. v. Oklahoma Tax Commission.
Rehearing denied.
CONCUR: Doolin, C.J., Hodges, Opala, Kauger, Summers, JJ.
DISSENT: Hargrave, V.C.J., Lavender, Simms, JJ.
NOT PARTICIPATING: Wilson, J.

F-1

Filed

SUPREME COURT
STATE OF OKLAHOMA

December 31, 1987

James W. Patterson
Clerk

IN THE SUPREME COURT
OF THE STATE OF OKLAHOMA

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLAREMORE, OKLAHOMA,

Appellant,

v.

THE OKLAHOMA TAX COMMISSION OF THE STATE OF OKLAHOMA,

Appellee,

and

GREAT PLAINS FEDERAL SAVINGS AND LOAN ASSOCIATION (FORMERLY CUSTER COUNTY FEDERAL SAVINGS AND LOAN ASSOCIATION) OF WEATHERFORD, OKLAHOMA,

Appellant,

v.

THE OKLAHOMA TAX COMMISSION OF THE STATE OF OKLAHOMA,

Appellee.

No. 64,673

(Surviving Number)

(Consolidated with

No. 64,674)

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that First Federal Savings and Loan Association of Claremore, Oklahoma and Great Plains Federal Savings and Loan Association (formerly Custer County Federal Savings and Loan Association) of Weatherford, Oklahoma hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of Oklahoma affirming in part and reversing in part Orders No. 85-05-30-07 and 85-05-30-39 (originally issued as Order No. 85-05-30-08) of the Oklahoma Tax Commission concerning the constitutionality of the Oklahoma corporate income tax under 68 Okla. Stat. § 2355 (1981) as applied to Federal Home Loan Bank deposits and Federal National Mortgage Association bonds, entered in this action on May 26, 1987, modified on October 6, 1987, and with rehearing denied on October 7, 1987.

Dee A. Replogle, Jr.
OBA #7509
Robert H. Gilliland, Jr.,
OBA #3382
Richard C. Craig,
OBA #10767
Tenth Floor
Two Leadership Square
Oklahoma City, Oklahoma
73102
(405) 235-9621

Attorneys for Appellant
First Federal Savings and
Loan Association and
Great Plains Federal Savings
and Loan Association

PROOF OF SERVICE

I, Robert H. Gilliland, Jr., certify that on the 31st day of December, 1987, a true and correct copy of the above has foregoing Notice of Appeal to the United States Supreme Court has been deposited in the United States mail, first-class postage prepaid, addressed to the following:

Oklahoma Tax Commission
2501 Lincoln Boulevard
Oklahoma City, Oklahoma 73194

Robert H. Gilliland, Jr.

C. *Corporations.* A tax is hereby imposed upon the Oklahoma taxable income of every corporation doing business within this state or deriving income from sources within this state in an amount equal to four percent (4%) thereof.

There shall be no additional Oklahoma income tax imposed on accumulated taxable income or on undistributed personal holding company income as those terms are defined in the Internal Revenue Code.

U.S. Const. art. I,

Sec. 8. [Powers of Congress.]

[1.] The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

[2.] To borrow money on the credit of the United States.

U.S. Const. art. VI,

Clause 2. Supreme law

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bould thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

General powers and duties of banks

(a) Borrowing money; issuing bonds and debentures; general powers. Each Federal Home Loan Bank shall have power, subject to rules and regulations prescribed by the board to borrow and give security therefor and to pay interest thereon, to issue debentures, bonds, or other obligations upon such terms and conditions as the board may approve, and to do all things necessary for carrying out the provisions of this Act and all things incident thereto.

(b) Issuance of consolidated Federal Home Loan Bank debentures; restrictions. The board may issue consolidated Federal Home Loan Bank debentures which shall be the joint and several obligations of all Federal Home Loan Bank organized and existing under this Act, in order to provide funds for any such bank or banks, and such debentures shall be issued upon such terms and conditions as the board may prescribe. No such debentures shall be issued at any time if any of the assets of any Federal Home Loan Banks are pledged to secure any debts or subject to any lien, and neither the board nor any Federal Home Loan Bank shall have power to pledge any of the assets of any Federal Home Loan Bank, or voluntarily to permit any lien to attach to the same while any of such debentures so issued are outstanding. The debentures issued under this section and outstanding shall at no time exceed five times the total paid-in capital of all the Federal Home Loan Banks as of the time of the issue of such debentures. It shall be the duty of the board not to issue debentures under this section in excess of the notes or obligations of member institutions held and secured under section 10(a) of this Act [12 USCS § 1430(a)] by all the Federal Home Loan Banks.

(c) Issuance of Federal Home Loan Bank bonds. At any time that no debentures are outstanding under this Act, or in order to refund all outstanding consolidated debentures issued under this section, the board may issue consolidated Federal Home Loan Bank bonds which shall be the joint and several obligations of all the Federal Home Loan Banks, and shall be secured and be issued upon such terms and conditions as the board may prescribe.

(d) Additional or substituted collateral on adjustment of equities. The board shall have full power to require any Federal Home Loan Bank to

deposit additional collateral or to make substitutions of collateral or to adjust equities between the Federal Home Loan Banks.

(e) **Acceptance of deposits; restrictions on transaction of banking business.** Each Federal Home Loan Bank shall have power to accept deposits made by members of such bank or by any other Federal Home Loan Bank or other instrumentality of the United States, upon such terms and conditions as the board may prescribe, but no Federal Home Loan Bank shall transact any banking or other business not authorized by this Act.

(f) **Rediscount of notes held by other banks; purchase of bonds of other banks.** The board is authorized and empowered to permit, or whenever in the judgment of at least four members of the board an emergency exists requiring such action, to require Federal Home Loan Banks, upon such terms and conditions as the board may prescribe, to rediscount the discounted notes of members held by other Federal Home Loan Banks, or to make loans to, or make deposits with, such other Federal Home Loan Banks, or to purchase any bonds or debentures issued under this section.

(g) **Reserves.** Each Federal Home Loan Bank shall at all times have at least an amount equal to the current deposits received from its members invested in (1) obligations of the United States, (2) deposits in banks or trust companies, (3) advances with a maturity of not to exceed five years which are made to members or nonmember borrowers, upon such terms and conditions as the Board may prescribe, and (4) advances with a maturity of not to exceed five years which are made to members or nonmember borrowers whose creditor liabilities (not including advances from the Federal Home Loan Bank) do not exceed 5 per centum of their net assets, and which may be made without the security of home mortgages or other security, upon such terms and conditions as the Board may prescribe.

(h) **Investment of surplus funds.** Such part of the assets of each Federal Home Loan Bank (except reserves and amounts provided in subsection (g)), as are not required for advances to members or nonmember borrowers, may be invested, to such extent as the bank may deem desirable and subject to such regulations, restrictions, and limitations as may be prescribed by the Board, in obligations of the United States, in obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association, in mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to section 305 or section 306 of the Federal Home Loan Mortgage Corporation Act [12 USCS § 1454 or § 1455], in stock of the Federal National Mortgage Association, and in such securities as fiduciary and trust funds may be invested in under the laws of the State in which the Federal Home Loan Bank is located.

(i) Treasury purchase of banks' obligations; exercise of authority. The Secretary of the Treasury is authorized in his discretion to purchase any obligations issued pursuant to this section, as heretofore, now, or hereafter in force and for such purpose the Secretary of the Treasury is authorized to use as a public-debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act [31 USCS §§ 747 et seq.], as now or hereafter in force, and the purposes for which securities may be issued under the Second Liberty Bond Act [31 USCS §§ 747 et seq.], as now or hereafter in force, are extended to include such purchases. The Secretary of the Treasury may, at any time, sell, upon such terms and conditions and at such price or prices as he shall determine, any of the obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such obligations under this subsection shall be treated as public-debt transactions of the United States. The Secretary of the Treasury shall not at any time purchase any obligations under this paragraph if such purchase would increase the aggregate principal amount of his then outstanding holdings of such obligations under this paragraph to an amount greater than $4,000,000,000. Each purchase of obligations by the Secretary of the Treasury under this subsection shall be upon terms and conditions as shall be determined by the Secretary of the Treasury and shall bear such rate of interest as may be determined by the Secretary of the Treasury taking into consideration the current average market yield for the month preceding the month of such purchase on outstanding marketable obligations of the United States.

In addition to obligations authorized to be purchased by the preceding paragraph, the Secretary of the Treasury is authorized to purchase any obligations issued pursuant to this section in amounts not to exceed $2,000,000,000. The authority provided in this paragraph shall expire August 10, 1975.

Notwithstanding the foregoing, the authority provided in this subsection may be exercised during any calendar quarter beginning after the date of enactment of the Depository Institutions Amendments of 1974 [Oct. 28, 1974] only if the Secretary of the Treasury and the Chairman of the Federal Home Loan Bank Board certify to the Congress that (1) alternative means cannot be effectively employed to permit members of the Home Loan Bank System to continue to supply reasonable amounts of funds to the mortgage market, and (2) the ability to supply such funds is substantially impaired because of monetary stringency and a high level of interest rates. Any funds borrowed under this subsection shall be repaid by the Home Loan Banks at the earliest practicable date.

(j) Audits. Notwithstanding the provisions of the first sentence of section 202 of the Government Corporation Control Act [31 USCS § 857], audits by the General Accounting Office of the financial transactions of a Federal Home Loan Bank shall not be limited to periods during which Govern-

ment capital has been invested therein. The provisions of the first sentence of subsection (d) of section 303 of the Government Corporation Control Act [31 USCS § 868(d)] shall not apply to any Federal Home Loan Bank.
(July 22, 1932, c. 522, § 11, 47 Stat. 733; June 27, 1934, c. 847, Title V, § 503, 48 Stat. 1261; June 27, 1950, c. 369, §§ 3, 4, 64 Stat. 257, 258; Aug. 2, 1954, c. 649, Title II, § 204(a), 68 Stat. 622; Sept. 2, 1964, P. L. 88-560, Title VII, § 701(d)(1), 78 Stat. 800; Aug. 1, 1968, P. L. 90-448, Title VIII, § 807(k), 82 Stat. 545; Dec. 23, 1969, P. L. 91-151, Title I, § 3, 83 Stat. 374; Dec. 31, 1970, P. L. 91-609, Title IX, § 914, 84 Stat. 1815; Aug. 22, 1974, P. L. 93-383, Title VII, § 805(c)(2), 88 Stat. 727; Oct. 28, 1974, P. L. 93-495, Title I, § 112, 88 Stat. 1506.)

12 U.S.C. § 1433.

Exemption from taxation; obligation acceptable as credit on debt of home owner

Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that in[1] any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued by any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any homeowner debtor of such bank. July 22, 1932, c. 522, § 13, 47 Stat. 735; May 28, 1935, c. 150, § 8, 49 Stat. 295.

1 So in original. Word "in" probably should be omitted.

12 U.S.C. § 1719.

Secondary market operations; Federal National Mortgage Association

(a) Purchase and sale of mortgages; maximum amount of loans; interest; maturity; settlement or extinguishment of borrower's rights. (1) To carry out the purposes set forth in paragraph (a) of section 301 [12 USCS § 1716(a)], the operations of the corporation under this section shall be confined, so far as practicable, to mortgages which are deemed by the corporation to be of such quality, type, and class as to meet, generally, the purchase standards imposed by private institutional mortgage investors. In the interest of assuring sound operation, the prices to be paid by the corporation for mortgages purchased in its secondary market operations under this section, should be established, from time to time, within the range of market prices for the particular class of mortgages involved, as determined by the corporation. The volume of the corporation's purchases and sales, and the establishment of the purchase prices, sale prices, and charges or fees, in its secondary market operations under this section, should be determined by the corporation from time to time, and such determinations should be consistent with the objectives that such purchases and sales should be effected only at such prices and on such terms as will reasonably prevent excessive use of the corporation's facilities, and that the operations of the corporation under this section should be within its income derived from such

operations and that such operations should be fully self-supporting. Nothing in this title shall prohibit the corporation from purchasing, and making commitments to purchase, any mortgage with respect to which the Secretary of Housing and Urban Development has entered into a contract with the corporation to make interest subsidy payments under section 243 of the National Housing Act [12 USCS § 1715z-8].

(2) In the further interest of assuring sound operation, any loan made by the corporation in its secondary market operations under this section, and any extension or renewal thereof, shall not exceed 90 per centum of the unpaid principal balances of the mortgages securing the loan, and shall bear interest at a rate consistent with general loan policies established from time to time by the corporation's board of directors. Any such loan shall mature in not more than twelve months and the term of any extension or renewal shall not exceed twelve months. The volume of the corporation's lending activities and the establishment of its loan ratios, interest rates, maturities, and charges or fees, in its secondary market operations under this section, should be determined by the corporation from time to time; and such determinations, in conjunction with determinations made under paragraph (1), should be consistent with the objectives that the lending activities should be conducted on such terms as will reasonably prevent excessive use of the corporation's facilities, and that the operations of the corporation under this section should be within its income derived from such operations and that such operations should be fully self-supporting. Notwithstanding any Federal, State, or other law to the contrary, the corporation is hereby empowered, in connection with any loan under this section, whether before or after any default, to provide by contract with the borrower for the settlement or extinguishment, upon default, of any redemption, equitable, legal, or other right, title, or interest of the borrower in any mortgage or mortgages that constitute the security for the loan; and with respect to any such loan, in the event of default and pursuant otherwise to the terms of the contract, the mortgages that constitute such security shall become the absolute property of the corporation.

(b) Obligations of the corporation. For the purposes of this section, the corporation is authorized to issue, upon the approval of the Secretary of the Treasury, and have outstanding at any one time obligations having such maturities and bearing such rate or rates of interest as may be determined by the corporation with the approval of the Secretary of the Treasury, to be redeemable at the option of the corporation before maturity in such manner as may be stipulated in such obligations; but the aggregate amount of obligations of the corporation under this subsection outstanding at any one time shall not exceed fifteen times the sum of its capital, capital surplus, general surplus, reserves, and undistributed earnings unless a greater ratio shall be fixed at any time or from time to time by the Secretary of Housing and Urban Development. In no event shall any such obligations be issued if, at the time of such proposed issuance,

and as a consequence thereof, the resulting aggregate amount of its outstanding obligations under this subsection would exceed the amount of the corporation's ownership pursuant to this section, free from any liens or encumbrances, of cash, mortgages or other security holdings, and obligations of the United States or guaranteed thereby, or obligations, participations, or other instruments which are lawful investments for fiduciary, trust, or public funds. The corporation shall insert appropriate language in all of its obligations issued under this subsection clearly indicating that such obligations, together with the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the corporation. The corporation is authorized to purchase in the open market any of its obligations outstanding under this subsection at any time and at any price.

(c) Purchase of obligations by Treasury; conditions and restrictions. The Secretary of the Treasury is authorized in his discretion to purchase any obligations issued pursuant to subsection (b) of this section, as now or hereafter in force, and for such purpose the Secretary of the Treasury is authorized to use as a public debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, as now or hereafter in force, and the purposes for which securities may be issued under the Second Liberty Bond Act, as now or hereafter in force, are extended to include such purchases. The Secretary of the Treasury shall not at any time purchase any obligations under this subsection if such purchase would increase the aggregate principal amount of his then outstanding holdings of such obligations under this subsection to an amount greater than $2,250,000,000. Each purchase of obligations by the Secretary of the Treasury under this subsection shall be upon such terms and conditions as to yield a return at a rate determined by the Secretary of the Treasury, taking into consideration the current average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the making of such purchase. The Secretary of the Treasury may, at any time, sell, upon such terms and conditions and at such price or prices as he shall determine, any of the obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such obligations under this subsection shall be treated as public debt transactions of the United States.

(d) Mortgage-backed securities; issuance; maturities; rates of interest; exempt securities; adequacy of mortgages to permit principal and interest payments. To provide a greater degree of liquidity to the mortgage investment market and an additional means of financing its operations under this section, the corporation is authorized to set aside any mortgages held by it under this section, and, upon approval of the Secretary of the Treasury, to issue and sell securities based upon the mortgages so set aside. Securities issued under this subsection may be in the form of debt obligations or trust certificates of beneficial interest, or both. Securities

issued under this subsection shall have such maturities and bear such rate or rates of interest as may be determined by the corporation with the approval of the Secretary of the Treasury. Securities issued by the corporation under this subsection shall, to the same extent as securities which are direct obligations of or obligations guaranteed as to principal and interest by the United States, be deemed to be exempt securities within the meaning of laws administered by the Securities and Exchange Commission. Mortgages set aside pursuant to this subsection shall at all times be adequate to enable the corporation to make timely principal and interest payments on the securities issued and sold pursuant to this subsection.

(e) Subordinated or convertible obligations; issuance; maturities; rate of interest; redemption; limitation on amount outstanding; exempt securities; debt or obligation of United States; purchases in open market. For the purposes of this section, the corporation is authorized to issue, upon the approval of the Secretary of the Treasury, obligations which are subordinated to any or all other obligations of the corporation, including subsequent obligations. The obligations issued under this subsection shall have such maturities and bear such rate or rates of interest as may be determined by the corporation with the approval of the Secretary of the Treasury and may be made redeemable at the option of the corporation before maturity in such manner as may be stipulated in such obligations. Any of such obligations may be made convertible into shares of common stock in such manner, at such price or prices, and at such time or times as may be stipulated therein. The total principal amount of such subordinated obligations which may be outstanding at any one time shall not exceed two times the sum of (1) the capital of the corporation represented by its outstanding common stock and (2) its surplus and undistributed earnings at such time. The outstanding total principal amount of such obligations, which are entirely subordinated to the obligations of the corporation issued or to be issued under subsection (b), shall be deemed to be capital of the corporation for the purpose of determining the aggregate amount of obligations issued under subsection (b) which may be outstanding at any one time. Obligations issued by the corporation under this subsection shall, to the same extent as securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, be deemed to be exempt securities within the meaning of laws administered by the Securities and Exchange Commission. The corporation shall insert appropriate language in all of its obligations issued under this subsection clearly indicating that such obligations, together with the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the corporation. The corporation is authorized to purchase in the open market any of its obligations outstanding under this subsection at any time and at any price.

(June 27, 1934, c. 847, Title III, § 304, 48 Stat. 1254; July 1, 1948, c. 784, § 1, 62 Stat. 1206; Aug. 2, 1954, c. 649, Title II, § 201, 68 Stat. 615; Aug. 7, 1956, c. 1029, Title II, §§ 203, 204, 70 Stat. 1096; Mar. 27, 1957, P. L.

85-10, § 1(c), 71 Stat. 7; July 12, 1957, P. L. 85-104, Title II, § 203, 71 Stat. 298; Sept. 23, 1959, P. L. 86-372, Title III, §§ 302, 305(a), 73 Stat. 669, 670; June 30, 1961, P. L. 87-70, Title VI, § 603(d), (e), 75 Stat. 176; Sept. 2, 1964, P. L. 88-560, Title VII, §§ 701(b)(2), 703, 704, 78 Stat. 800, 802; Sept. 10, 1966, P. L. 89-566, § 1, 80 Stat. 738; Nov. 3, 1966, P. L. 89-754, Title X, § 1007, 80 Stat. 1285; Aug. 1, 1968, P. L. 90-448, Title VIII, §§ 802(o)–(s), 804(a), 805, 82 Stat. 538, 542, 543; July 24, 1970, P. L. 91-351, Title V, § 504, 84 Stat. 461; Aug. 22, 1974, P. L. 93-383, Title VIII, § 806(j), 88 Stat. 728.)

Title 31 USC § 742

Establishes a broad exemption of federal obligations from state and local taxation:

"Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."